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No. 90-913-CFX
Status: GRANTED

Title: Board of Governors of the Federal Reserve System of the United States, Petitioner
v.
MCorp Financial, Inc., et al.

Docketed:
December 10, 1990

Court: United States Court of Appeals for the Fifth Circuit

Vide:
90-914

Counsel for petitioner: Solicitor General

Counsel for respondent: Miller,Harvey R., Chapman,Jerome I.

10/22: ord. granting ext. of time, to 12/10, by Scalia, J. (CITED)

Entry	Date	Note	Proceedings and Orders
1	Oct 19 1990	G	Application (A90-305) to extend the time to file a petition for a writ of certiorari from November 4, 1990 to December 10, 1990, submitted to Justice Scalia.
2	Oct 22 1990		Application (A90-305) granted by Justice Scalia extending the time to file until December 10, 1990.
3	Dec 10 1990	G	Petition for writ of certiorari filed.
5	Dec 20 1990		Order extending time to file response to petition until February 9, 1991.
6	Dec 20 1990		The above extension is for all respondents.
7	Feb 11 1991		Brief of respondents MCORP Financial, Inc., et al. in opposition filed.
8	Feb 11 1991		Lodging received.
9	Feb 13 1991		DISTRIBUTED. March 1, 1991
10	Feb 22 1991	X	Reply brief of petitioner Board of Governors of Federal Reserve System filed.
11	Mar 4 1991		Petition GRANTED. The case is consolidated with 90-914, and a total of one hour is allotted for oral argument.
			**
12	Apr 1 1991		Record filed.
		*	certified copy of original record on appeal, 8 vol., exhibits to Doc #35 SEALED Folder (Box)
13	Apr 11 1991		Joint appendix filed. VIDED.
14	Apr 17 1991		Brief of petitioner Board of Governors of Federal Reserve System, US filed. VIDED.
16	Apr 30 1991		Order extending time to file brief of respondent on the merits until June 10, 1991.
17	Jun 10 1991		Brief of respondents MCORP Financial, Inc., et al. filed. VIDED.
21	Jun 25 1991	D	Motion of respondents and cross-petitioners MCorp, et al. for divided argument filed.
19	Jul 11 1991	X	Reply brief of petitioner Board of Governors of Federal Reserve System filed. VIDED.
18	Jul 12 1991		CIRCULATED.
20	Jul 19 1991		SET FOR ARGUMENT MONDAY, OCTOBER 7, 1991. (2ND CASE)
22	Sep 13 1991		Motion of respondents and cross-petitioners MCorp, et al. for divided argument DENIED.
23	Sep 24 1991	X	Supplemental brief of respondents MCORP Financial, Inc., et al. filed. VIDED.

app

No. 90-913-CFX

Entry	Date	Note	Proceedings and Orders
24	Sep 27 1991	X	Supplemental brief of petitioner Board of Governors of Federal Reserve System filed. VIDED.
25	Oct 7 1991		ARGUED.

No. 90-913

In the Supreme Court of the United States

OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether despite the express limitation of 12 U.S.C. 1818(i)(1), the district court may invoke *Leedom* v. *Kyne*, 358 U.S. 184 (1958), to exercise jurisdiction over a bank holding company's claim that the Federal Reserve Board lacked statutory authority to file administrative charges enforcing its "source of strength" regulations.

2. Whether the Federal Reserve Board has statutory authority to promulgate and enforce its "source of strength" regulations, which make bank holding companies responsible for maintaining adequate capitalization of subsidiary banks.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, MCorp and MCorp Management were plaintiffs in the district court and appellees in the court of appeals. The Official Creditors' Committee of MCorp, MCorp Financial, Inc., and MCorp Management was an intervenor in the district court and an appellee in the court of appeals.

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System of the United States of America, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* 1a-26a) is reported at 900 F.2d 852. The opinion of the district court (App., *infra,* 29a-48a) is reported at 101 Bankr. 483.

JURISDICTION

The judgment of the court of appeals was entered on May 15, 1990. A petition for rehearing was denied on August 6, 1990. App., *infra,* 27a-28a. On October 22, 1990, Justice Scalia extended the time within which to file a petition for a writ of certiorari to and including December 10, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent sections of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(a), 1842(c), 1844) are reprinted at App., *infra,* 49a-55a. Pertinent sections of the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818), as amended by Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, are reprinted at App., *infra,* 55a-70a. Sections 908 and 910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3907, 3909) are reprinted at App., *infra,* 70a-72a. Pertinent sections of Federal Reserve Board regulations, 12 C.F.R. Part 225, are reprinted at App., *infra,* 72a-75a.

STATEMENT

A. The Statutory and Regulatory Scheme

1. Congress has vested the Board of Governors of the Federal Reserve System with substantial supervisory authority over the formation, structure, and operation of bank holding companies, *i.e.*, any company that has direct or indirect control of any bank. 12 U.S.C. 1841(a)(1). The Board exercises such authority under three related statutory schemes, the Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. 1841 *et seq.*, the International Lending Supervision Act of 1983 (ILSA), 12 U.S.C. 3901 *et seq.*, and the Financial Institutions Supervisory Act (FISA), 12 U.S.C. 1818, as amended by Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, Tit. IX, 103 Stat. 450-451.

Under the BHCA, a company may not acquire a bank without first obtaining the Board's approval. 12 U.S.C. 1842(a). In reviewing a company's application to buy a bank, the Board must consider, among other factors, "the financial and managerial resources and future prospects of the company or companies and the banks concerned." 12

U.S.C. 1842(c); see *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978). The BHCA generally requires the company to limit its operations to banking activities and to other "nonbanking" activities that are closely related or incident to banking. 12 U.S.C. 1843; see also 12 C.F.R. 225.21-225.31.[1] Under its supervisory power, the Board "from time to time may require reports [from] * * * and * * * may make examinations of each bank holding company and each subsidiary thereof." 12 U.S.C. 1844(c). The Board has authority to curtail a bank holding company's "nonbank" activities that pose risks to a bank's financial stability or are "inconsistent with sound banking principles or with the purposes of [the BHCA]." 12 U.S.C. 1844(e); see, *e.g.*, *Independent Ins. Agents* v. *Board of Governors,* 890 F.2d 1275 (2d Cir. 1989), cert. denied, 111 S. Ct. 44 (1990).

Under Sections 908 and 910 of ILSA, 12 U.S.C. 3907 and 3909, the Board regulates and enforces the capital adequacy of each holding company. Section 908 empowers the Board to establish minimum capital levels, 12 U.S.C. 3907(a), and provides that the failure of a holding company's insured bank to maintain these capital levels "may be deemed by the [Board], in its discretion, to constitute an unsafe and unsound practice within the meaning of [12 U.S.C. 1818]," 12 U.S.C. 3907(b)(1); see 12 U.S.C. 3909(a)(2). Moreover, ILSA provides that the Board may order holding companies to achieve required levels of capital where necessary to remedy unsafe or unsound banking practices. 12 U.S.C. 3909(a)(2); see 12 C.F.R. 263.35-263.40.

Under FISA, the Board has authority to begin "cease-and-desist" proceedings against a bank holding company if, in the Board's view, the company "is engaging or has engaged" or the Board "has reasonable cause to believe that

[1] The BHCA empowers the Board to "issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of the [the Act] and prevent evasions thereof." 12 U.S.C. 1844(b).

[the company] is about to engage, in an unsafe or unsound practice in conducting the business of such [company]." 12 U.S.C. 1818(b)(1); see 12 U.S.C. 1818(b)(3) (Board's authority under Section 1818(b) applies to "any bank holding company, and to any subsidiary (other than a bank) of a bank holding company"). After an administrative hearing,[2] the Board may direct the holding company to "take affirmative action to correct the conditions resulting from any such violation or practice." 12 U.S.C. 1818(b)(1). As amended by Section 902 of FIRREA, FISA further provides that the Board's remedial powers include the authority to order the offending holding company to make restitution to subsidiaries, to dispose of a loan or asset, or to "take such other action as [the Board] determines to be appropriate." 103 Stat. 450-451 (to be codified at 12 U.S.C. 1818(b)(6)).

In addition, under FISA, the Board has authority to issue a temporary cease-and-desist order—without first holding a hearing—if it finds that the unsafe or unsound practice "is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors" before completion of administrative proceedings under Section 1818(b)(1). 12 U.S.C. 1818(c)(1). The Board's order under this provision may direct "affirmative action to prevent

[2] FISA and the Board's implementing regulations establish comprehensive procedures for exercising these enforcement powers. The statute requires sufficient notice to the holding company of the underlying charge, an evidentiary hearing before an independent presiding official, and a decision based on the hearing record. 12 U.S.C. 1818(b)(1), (b)(3), 1818(h). Board regulations further provide that the holding company may appear through counsel, compel the attendance of witnesses and the production of documents, adduce any relevant and material evidence, cross-examine adverse witnesses, and present its position through written submissions and oral argument. 12 C.F.R. 263.1 *et seq.*

such insolvency, dissipation, condition, or prejudice pending completion of such proceedings." 12 U.S.C. 1818(c)(1). Such an order is effective immediately upon service and is enforceable by injunction in the appropriate United States District Court. 12 U.S.C. 1818(c)(1) and (d).

FISA provides specific avenues for judicial review of matters involving the Board's enforcement actions. First, a bank holding company may petition for review of a *final* cease-and-desist order under the Administrative Procedure Act, 5 U.S.C. 701 *et seq.*, in the appropriate United States Court of Appeals. 12 U.S.C. 1818(h)(2).[3] Second, the United States District Courts have jurisdiction to issue an injunction "setting aside, limiting, or suspending" a *temporary* cease-and-desist order pending completion of the administrative enforcement proceedings. 12 U.S.C. 1818(c)(2). Third, upon the Board's application, the district courts have jurisdiction to enforce compliance with any notice or order issued under Section 1818. 12 U.S.C. 1818(i)(1). FISA, however, expressly bars federal courts from assuming jurisdiction to review or intervene in the Board's enforcement proceedings in any other manner or circumstance, stating that

> except as otherwise provided in [12 U.S.C. 1818] no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. 1818(i)(1); see 12 U.S.C. 1818(h)(1).

2. As part of its supervision of bank holding companies' corporate practices, the Board's "source of strength"

[3] Once a petition for review is filed, FISA provides that the court of appeals' jurisdiction shall be "exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency." 12 U.S.C. 1818(h)(2). The sole exception to this exclusive jurisdiction is limited to instances where the Board, with the court's permission, modifies, terminates, or sets aside its order. See 12 U.S.C. 1818(h)(1) and (2).

regulation generally provides that "[a] bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not con[d]uct its operations in an unsafe or unsound manner." 12 C.F.R. 225.4(a)(1) (Regulation Y). The Board first articulated the policy reflected in that regulation in its case-by-case review of companies' applications to acquire banks. In reviewing these applications, the Board made clear that it would not approve bank acquisitions unless the prospective parent holding company would retain the ability to act as a source of financial and managerial assistance to its subsidiary banks, should the need for such assistance arise.[4] And in *First Lincolnwood Corp.*, 439 U.S. at 248, this Court upheld the Board's authority to disapprove the formation of a bank holding company on the basis of the grounds asserted in those administrative determinations, namely, the applicant's inability to act as a "source of strength" to subsidiary banks.

In 1984, the Board codified the source of strength policy in its published regulations governing a holding company's corporate practices. See 49 Fed. Reg. 818, 820 (1984). As part of that codification, the Board explained that its source of strength regulation

> is derived from section 3(c) of the BHC Act [12 U.S.C. 1842(c)], which requires the Board to consider the financial and managerial resources and future prospects of the company and banks concerned; from section 5(b) of the BHC Act [12 U.S.C. 1844(b)], which authorizes the Board to issue regulations; and from the Board's authority under the Financial Institutions Supervisory Act to issue cease-and-desist orders to prevent unsafe or unsound banking practices (12 U.S.C. 1818(b)(1) and (3)).

[4] See, *e.g.*, *Citizens Bancorporation*, 61 Fed. Res. Bull. 806, 806 (1975); *Midwest Bancorporation, Inc.*, 56 Fed. Res. Bull. 948, 950 (1970); *Mid-Continent Bancorporation*, 52 Fed. Res. Bull. 198, 200 (1966).

48 Fed. Reg. 23,520, 23,523 (1983) (notice of proposed rulemaking).

In 1987, the Board issued a formal statement clarifying its long-standing policy that bank holding companies should act as sources of strength to their subsidiary banks by "stand[ing] ready to use available resources to provide adequate capital funds to * * * subsidiary banks during periods of financial stress or adversity." *Policy Statement; Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks*, 52 Fed. Reg. 15,707, 15,707 (1987). In support of that policy, the Board pointed out that a holding company derives financial benefits from ownership of institutions that can accept federally insured deposits, and reasoned that these commercial advantages create a correlative obligation to serve as sources of strength and support to subsidiary banks. *Ibid.* The Board also stated that bolstering a subsidiary bank's capital cushion promotes bank safety and public confidence, and reduces the federal deposit insurance fund's exposure to loss. *Ibid.* Accordingly, the Board stated that "[a] bank holding company's failure to assist a troubled or failing subsidiary bank * * * would generally be viewed as an unsafe and unsound banking practice or a violation of Regulation Y or both" that would result in an appropriate enforcement action. *Id.* at 15,707-15,708.

B. The Proceedings in This Case

1. In October 1988, the Board issued a "notice of charges" under 12 U.S.C. 1818(b) against respondent MCorp, a bank holding company headquartered in Texas, and two of its subsidiaries, respondents MCorp Financial, Inc., and MCorp Management (collectively MCorp). MCorp owned 25 subsidiary banks, many of which were in deteriorating financial condition and could not meet the Comptroller of the Currency's requirements for minimally acceptable capital reserves. The Board alleged that MCorp

> was engaging in unsafe and unsound practices, likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the subsidiary Banks.

App., *infra,* 2a; see *id.* at 31a.[5] Accordingly, the Board notified MCorp of the convening of an administrative hearing to determine whether the company should be ordered to cease and desist from specified unsafe and unsound practices and to undertake appropriate remedial measures. In an amended notice filed a week later, the Board sought to require MCorp to

> implement[ ] an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies.

Id. at 2a.

At the same time, the Board issued temporary cease-and-desist orders under 12 U.S.C. 1818(c)(1) that prohibited MCorp from dissipating its assets through dividend payments or unusual business transactions, and directed MCorp to identify those subsidiary banks that would receive capital infusions from MCorp's corporate assets and resources. See Order, *In re MCorp,* No. 88-062-C-HC (Fed. Res. Bd. Oct. 19, 1988); Amended Order, *In re MCorp,* No. 88-062-C-HC (Fed. Res. Bd. Oct. 26, 1988).

The Board postponed resolution of the "source of strength" charges pending MCorp's attempt to secure "open bank" financial assistance from the Federal Deposit Insurance Corporation. See 12 U.S.C. 1823(c). In late March 1989, however, the FDIC denied MCorp's request, concluding that such financial assistance would not be in the public interest.

2. Soon after the FDIC's decision, three of MCorp's creditors filed an involuntary petition against MCorp in the United States Bankruptcy Court for the Southern District of New York. On March 28 and 29, 1989, the Comptroller of the Currency declared a total of 20 of MCorp's 25 subsidiary banks insolvent and, by operation of law, placed them under the receivership of the FDIC. On March 31, MCorp filed voluntary bankruptcy petitions in the United States Bankruptcy Court for the Southern District of Texas. App., *infra,* 2a-3a, 31a-32a.[6]

At this time, the Board issued a second notice of charges against MCorp. This notice alleged that MCorp had violated Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, which, among other things, imposes collateral requirements on extensions of credit by a subsidiary bank to a nonbank affiliate.[7] And in late May 1989, the Board

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[5] In particular, the Board alleged that it had reasonable cause to believe that

> MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, and (2) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

Notice of Charges ¶ 7(b), *In re MCorp,* No. 88-062-B-HC (Fed. Res. Bd. Oct. 19, 1988).

In the amended notice of charges filed one week later, the Board also alleged that it had reasonable cause to believe that "MCorp will not take the actions that are necessary * * * to use all available resources to make immediate capital injections into the Subsidiary Banks." Amended Notice of Charges ¶ 8(b), *In re MCorp,* No. 88-062-B-HC (Fed. Res. Bd. Oct. 26, 1988).

[6] The voluntary and involuntary bankruptcy proceedings were later consolidated in the Southern District of Texas. App., *infra,* 3a.

[7] In particular, the notice claimed that MCorp had caused two of its closed banks to lend $63.7 million to MCorp Management without requiring sufficient collateral. App., *infra,* 3a.

issued a second amended notice of charges (relating to the original October 1988 notice), alleging that MCorp had failed to act as a "source of strength" to its five remaining subsidiary banks. App., *infra,* 3a.

3. Before the Board held an administrative hearing on the outstanding charges, MCorp filed an adversary bankruptcy proceeding against the Board in the Southern District of Texas. MCorp sought a temporary restraining order and a preliminary injunction to prevent the Board from prosecuting its administrative charges and taking further actions against MCorp without prior approval of the bankruptcy court. On May 3, 1989, the bankruptcy court denied MCorp's request for temporary relief. App., *infra,* 3a.

The Board then filed in the district court for the Southern District of Texas a motion to withdraw the reference of the adversary proceeding to the bankruptcy court. See 28 U.S.C. 157(d). The district court granted that motion on May 12, thereby agreeing to exercise jurisdiction over MCorp's request for injunctive relief. App., *infra,* 3a.

On June 9, the district court granted MCorp's motion and issued a preliminary injunction against the Board's administrative enforcement proceedings. App., *infra,* 29a-48a. The court concluded that the express jurisdictional limitation contained in FISA, 12 U.S.C. 1818(i)(1)—providing that "no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement" of any Board order, except as set forth in the statute—has "been overridden through control of the debtor's estate having been entrusted to the authority of the bankruptcy court." App., *infra,* 37a; see 28 U.S.C. 1334(d). Alternatively, the court determined that "the Board's generalized, diffuse interest in the holding company as well as the duplicative, distracting hearings militate for its being not exempt from the [automatic stay provisions of the Bankruptcy Code, 11

U.S.C. 362]." App., *infra,* 41a.[8]

C. The Court of Appeals Decision

In May 1990, the Fifth Circuit vacated the injunction with respect to proceedings on the Board's Section 23A charges,[9] but remanded with instructions to enjoin proceedings on the Board's source of strength charges because those "proceedings exceeded its statutory authority." App., *infra,* 2a.

With respect to its jurisdiction, the court of appeals concluded that

> the plain language of § 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings if the Board's actions do not exceed the authority Congress granted to it.

App., *infra,* 11a. Nevertheless, citing *Leedom* v. *Kyne,* 358 U.S. 184 (1958) and circuit precedent, the court determined that

> [i]f the Board's proceedings exceed its statutory authority, we may review the Board's action * * * despite the jurisdictional bar of § 1818; if the Board "was not acting within [the] authority granted by Congress, then 12 U.S.C. § 1818(i) could not withdraw jurisdiction."

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[8] Moreover, the court held that it had general equitable power under 11 U.S.C. 105 to enjoin the Board's proceedings that would threaten MCorp's assets or otherwise impede MCorp's reorganization. App., *infra,* 41a-42a.

[9] With regard to those proceedings, the court concluded that the Board has authority to regulate MCorp's relationships with former subsidiary banks. App., *infra,* 4a-11a. The court also concluded that the Board was "well within its authority in seeking an order against MCorp to cease and desist any transactions which violate the provisions of [Section 23A], or " 'to take affirmative action' as may be appropriate." App., *infra,* 13a (quoting 12 U.S.C. 1818(b)(1)).

App., *infra,* 11a (quoting *Manges* v. *Camp,* 474 F.2d 97, 99 (5th Cir. 1973)).

Turning to the Board's "source of strength" proceedings, the court of appeals rejected the argument that MCorp may not challenge the Board's authority because it has not exhausted its administrative remedies. In the court's view, "[t]he sole question presented is a legal one * * * [and that] legal issue * * * can be resolved without further factual development." App., *infra,* 14a-15a. On the merits, the court acknowledged that, under 12 U.S.C. 1842(c), the Board has "authority to consider financial and managerial soundness of subsidiary banks [when deciding whether] to grant or deny a holding company's application." App., *infra,* 20a (citing *First Lincolnwood Corp., supra*). But the court concluded that the BHCA "does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application." App., *infra,* 20a. Accordingly, the court held that "the Board is without authority under the BHCA to require [MCorp] to transfer its funds to its troubled subsidiary bank." App., *infra,* 21a.[10]

The court of appeals also rejected the Board's contention that "MCorp's failure to provide capital to its subsidiary banks is an unsafe or unsound practice which the Board may act to restrain under [FISA, 12 U.S.C. 1818]." App., *infra,* 21a. Applying the framework established by *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984), the court determined that "Congress has not spoken clearly to what constitutes an

[10] The court suggested that the Board was not necessarily without an adequate alternative to its "source of strength" regulations. In its view, "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial soundness." App., *infra,* 21a n.5 (noting similar practice of the Office of Thrift Supervision).

unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies." App., *infra,* 22a. The court therefore examined the "reasonableness" and "permissibility" of the Board's construction of that phrase, *i.e.,* that a "failure of the holding company to inject capital into subsidiary banks is an 'unsafe or unsound' practice." App., *infra,* 22a.

In the court's view, "[e]nforcement of the Board's source of strength regulation * * * can hardly be considered a 'generally accepted standard[ ] of prudent operation.' " App., *infra,* 23a (quoting 112 Cong. Rec. 26,474 (1966), cited in *Gulf Federal Savings & Loan Ass'n* v. *Federal Home Loan Bank Bd.,* 651 F.2d 259, 264 (5th Cir. 1981), cert. denied, 458 U.S. 1121 (1982)). Not only would such a transfer of funds require a holding company such as MCorp "to disregard its own corporation's separate status," that transfer also "would amount to a wasting of the holding company's assets in violation of its duty to shareholders." App., *infra,* 23a. Moreover, the court stated that the Board's regulations conflict with "one of the fundamental purposes of the BHCA," namely, "to separate banking from commercial enterprises," since those regulations would permit the Board "to treat a holding company as merely an extension of its subsidiary bank." App., *infra,* 23a.[11] Accordingly, the court concluded that

> the Board's determination that the holding company's failure to transfer its assets to a troubled subsidiary was an "unsafe or unsound practice" under §§ 1818(b)(1) and (3) is an unreasonable and impermissible interpretation of that term.

[11] In this regard, the court noted that Congress, in enacting and amending the BHCA in 1956 and 1966, "set forth detailed limits on transactions considered unsound between subsidiary banks and holding companies, without mentioning the infusion of capital by holding companies into subsidiaries." App., *infra,* 24a.

App., *infra*, 25a.[12]

REASONS FOR GRANTING THE PETITION

In striking down the Federal Reserve Board's source of strength policy, the court of appeals has invalidated a longstanding, frequently invoked, and critically important federal regulatory tool for safeguarding the stability of the Nation's banking institutions. The decision below rests on a flawed construction of the interrelated statutory schemes Congress established in the Bank Holding Company Act, the Financial Institutions Supervisory Act, and the International Lending Supervision Act, to empower the Board to supervise bank holding companies' activities regarding subsidiary banks. Such a substantial narrowing of the Federal Reserve Board's authority in this important regulatory arena calls for this Court's review.

Moreover, the court of appeals effectively reached out to nullify the Board's policy by misappropriating jurisdiction under the doctrine set forth in *Leedom* v. *Kyne*, 358

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[12] On August 6, 1990, the court of appeals denied the Board's petition for rehearing and suggestion of rehearing en banc. App., *infra*, 27a-28a. On August 23, the court of appeals denied MCorp's motion for a stay of the mandate.

On remand from the court of appeals, the district court recently entered an order enjoining the Board from, among other activities, prosecuting its outstanding source of strength administrative charges against MCorp. Injunction on Remand ¶ 4, *MCorp* v. *Board of Governors*, No. H-89-1677 (S.D. Tex. Nov. 8, 1990). The Board's motion for a modification of that injunction is pending before the district court.

MCorp, through the pending bankruptcy proceedings, is currently pursuing plans to sell each of its remaining five subsidiary banks. MCorp has executed contracts to sell three of those banks. None of those transactions has been closed; one of the contracts has not yet received the requisite approvals from either the bankruptcy court or the Comptroller of the Currency.

U.S. 184 (1958). Such an exercise of jurisdiction – in the face of the express preclusion provision of 12 U.S.C. 1818(i)(1) – conflicts with this Court's decision in *Leedom* v. *Kyne*, and the decisions of other courts of appeals applying *Leedom*. In view of the substantial importance of the federal banking policy at stake, and the court of appeals' misuse of *Leedom* v. *Kyne* to circumvent the exclusive judicial review provisions crafted by Congress in FISA, further review by this Court is plainly warranted.

1. The court of appeals – by striking down the "source of strength" policy – has stripped the Federal Reserve Board of a critically important enforcement tool for safeguarding the stability of the Nation's banking institutions. Since enactment of the Bank Holding Company Act of 1956, the Board has frequently relied on the source of strength policy to bolster the capital reserves of weakened subsidiary banks, principally by initiating negotiations and other informal supervisory actions to obtain bank holding companies' cooperation in ensuring that banking subsidiaries remain adequately capitalized. Since the policy was first articulated, the Board – without resort to formal administrative proceedings – has managed to obtain hundreds of voluntary agreements, consent cease-and-desist orders, and memoranda of understanding that have required bank holding companies to inject capital into financially troubled subsidiaries.[13] The decision below,

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[13] The specific terms and underlying circumstances of these source of strength enforcement actions are often unreported. This state of affairs stems from the fact that those actions are informal and from the Board's previous policy of keeping the terms of recapitalization agreements confidential in order to prevent a loss of public confidence in the banking institution. The Board, however, has noted the use of these voluntary "source of strength" agreements in its annual reports on enforcement actions. See, *e.g.*, *1989 Annual Report on Formal Enforcement Actions* 15, 17; *1988 Annual Report on Formal Enforcement Actions* 19; *1987 Annual Report on Formal Enforcement Actions* 13; *1986 Annual Report on Formal Enforcement Actions* 15; *1985 Annual Report on Formal Enforcement Actions* 16.

however, has now undermined the Board's legal authority to back these informal negotiations with the power to enforce its stated regulatory policies. As such, it casts considerable uncertainty over the Board's ability to secure holding companies' agreements to maintain the capital adequacy of subsidiary banks.

That uncertainty is particularly daunting today in light of the concentration of assets controlled by bank holding companies. As of 1990, holding companies controlled over 8,800 banks and 92 percent of the assets of all insured commercial banks in the country. See Board of Governors of the Federal Reserve System, *76th Annual Report, 1989,* at 170-171. The failure of even a small fraction of these subsidiary banks would undermine the stability of the banking system and drastically overburden the already strapped federal banking insurance system.[14] Indeed, the FDIC's plan to rescue those MCorp subsidiary banks that have already failed is alone expected to cost the insurance system $2 billion, making the plan the second most expensive bank rescue ever undertaken.

Absent recourse to the Board's source of strength policy, there are no alternative regulatory means of effectively redressing the substantial problems posed by inadequately capitalized subsidiary banks. The Comptroller of the Currency can issue capital directives instructing troubled subsidiary banks to obtain new financing. See 12 U.S.C. 3907(b)(2); 12 C.F.R. 3.15-3.21. But in the Board's experience, it is virtually impossible to persuade new investors to make minority position investments in weakened banks controlled by other, independent interests

[14] The General Accounting Office has recently reported to Congress that the federal bank insurance fund ended 1989 with a net loss of $852 million and that the ratio of the fund balance to insured deposits is at the lowest level ever recorded. See General Accounting Office, *Bank Insurance Fund* 5 (1990).

represented by bank holding companies, particularly where the holding companies themselves are unwilling to support their subsidiaries.

Under the "cross-guaranty" provisions of Section 206(e) of FIRREA, Tit. II, 103 Stat. 201 (to be codified at 12 U.S.C. 1818(e)), the FDIC can now order subsidiary banks to pay for losses incurred by the FDIC in disposing of failed banks within multibank holding company systems. These provisions, however, fall short of the Board's more potent authority under the source of strength regulations. The newly enacted cross-guaranty provisions do not authorize enforcement steps to be taken against the solvent holding companies themselves, and do not even come into play unless there has been a default or an imminent danger of collapse.

The regulatory vacuum created as a result of the court of appeals' decision poses substantial risks for the stability of the Nation's banking system. Once bank holding companies choose to abandon troubled subsidiaries, the holding companies have strong incentives to transfer valuable business operations and assets elsewhere, thereby further weakening the subsidiaries, increasing the likelihood of insolvency, and ultimately exposing the banking insurance fund to additional liabilities. Indeed, absent the source of strength regulations, bank holding companies could—subject to statutory limits on inter-affiliate transactions—routinely draw profits away from subsidiary banks in good years, but then allow them to slip unaided into insolvency in lean years. The court of appeals' decision could thus create an incentive for holding companies to maximize the short-term, cyclical profits of their subsidiary banks, regardless of risk, because the bank insurance fund—not the parent holding companies—would ultimately bear the costs if the subsidiaries later fail.

We recognize that the Fifth Circuit is the first court of appeals to consider the validity of the Board's source of

strength policy. Nonetheless, the decision below will likely have nationwide significance. According to statistics compiled by the Board, the number of national bank failures in the States that comprise the Fifth Circuit – Texas, Louisiana, and Mississippi – accounted for 62.7% of all bank failures in the United States in 1988, 76% of all bank failures in 1989, and 68.7% of all bank failures in 1990. On this issue, the Fifth Circuit is where the action is. Moreover, the General Accounting Office has recently notified Congress that the banks in the greatest danger of failing remain concentrated in, among other areas, the Southwest. General Accounting Office, *Bank Insurance Fund* 4 (1990). In other words, the court of appeals' decision divests the Federal Reserve Board – the principal regulator of bank holding companies – of the power to enforce capital standards on companies located in that part of the country where the threat to bank stability remains substantial and where additional capital infusions will most likely be needed.

2. The Fifth Circuit should not have even have had the opportunity to err. In reaching the issue of the validity of the Board's source of strength regulations, the court of appeals misapplied the doctrine set forth in *Leedom* v. *Kyne*, 358 U.S. 184 (1958), to exercise jurisdiction despite FISA's explicit preclusion provision, 12 U.S.C. 1818(i)(1). The Fifth Circuit's misapplication is not only fundamentally inconsistent with this Court's decision in that case, it also conflicts with decisions from other circuits properly construing *Leedom*'s reach.[15]

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[15] Moreover, by authorizing the district court to broaden its injunction on remand – in the absence of a cross-appeal filed by MCorp – the court of appeals may well have exceeded its appellate jurisdiction. See *United States* v. *American Ry. Express Co.*, 265 U.S. 425, 435 (1924).

a. In *Leedom*, union representatives challenged a National Labor Relations Board order including both professional and nonprofessional employees within the same collective bargaining unit without the professional employees' consent. 358 U.S. at 186. This Court held that although the bargaining unit certifications were not reviewable final orders under the National Labor Relations Act, the district court nonetheless had jurisdiction to consider the union's challenge. *Id.* at 191. The Court explained that that lawsuit was

> not one to "review," in the sense of that term as used in the [National Labor Relations] Act, a decision of the Board made within its jurisdiction. Rather it is one to strike down an order of the Board made in excess of its delegated powers and contrary to a specific prohibition in the Act.

Id. at 188. The Court noted that it could not "lightly infer that Congress does not intend judicial protection of rights it confers against agency action taken in excess of delegated powers." *Id.* at 190. As a result, the Court concluded that, despite the governing statute's failure to provide for judicial review, Congress intended that the statutory rights violated by the NLRB remain judicially enforceable through the general jurisdiction of the federal courts. *Id.* at 190-91.

b. This Court has emphasized "the painstakingly delineated procedural boundaries of [*Leedom* v. *Kyne*]," making plain that the "*Kyne* exception [to statutory judicial review provisions] is a narrow one." *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 481 (1964); see *Brotherhood of Ry. & S.S. Clerks* v. *Association for the Benefit of Non-Contract Employees*, 380 U.S. 650, 660 (1965). The court of appeals' invocation of *Leedom* – on the record presented here – ignores the Court's limitations in several critical respects.

First, *Leedom* neither held nor suggested that federal courts could invoke their "general jurisdiction" to review agency action, particularly where, as here, the governing statute itself provides an exclusive avenue of review that affords a full and complete means of securing judicial vindication of statutorily created rights. *Leedom*'s jurisdictional holding was largely predicated on the fact that the union had no other effective means of obtaining judicial review and thus would have been left without *any* judicial remedy for a right created by Congress. 358 U.S. at 190-91; see *id.* at 197 (Brennan, J., dissenting). This Court has recognized that where Congress *has* provided an avenue of judicial review, that avenue must be followed; as a result, claims of unlawful agency action must be resolved in the manner, time, and forum ordained by Congress. *E.g., Whitney Nat'l Bank* v. *Bank of New Orleans & Trust Co.,* 379 U.S. 411, 419-423 (1965). For that reason, the courts of appeals – contrary to the decision below – have consistently rejected invocation of jurisdiction under *Leedom* v. *Kyne* where Congress has provided adequate, alternative means of judicial review of agency action.[16]

Here, Congress has certainly provided companies in MCorp's position an adequate means of obtaining judicial review over any question pertaining to an exercise of the Board's regulatory enforcement power or authority that has binding legal effect. The court of appeals was thus wrong to label 12 U.S.C. 1818(i)(1) a "jurisdictional bar."

[16] See, *e.g., Telecommunications Research and Action Center* v. *FCC*, 750 F.2d 70, 78 (D.C. Cir. 1984); *Quivira Mining Co.* v. *EPA*, 728 F.2d 477, 484 (10th Cir. 1984), cert. denied, 474 U.S. 1055 (1986); *Compensation Dep't* v. *Marshall*, 667 F.2d 336, 343-344 (3d Cir. 1981); *Nor-Am Agricultural Products, Inc.* v. *Hardin*, 435 F.2d 1151, 1159-1160 (7th Cir. 1970) (en banc), cert. dismissed, 402 U.S. 935 (1971); but see *Greater Detroit Resource Recovery Auth. & Combustion Eng'g* v. *EPA*, No. 88-2269 (6th Cir. Aug. 30, 1990), slip op. 11.

App., *infra,* 11a. Rather, that statute provides only that no court shall have jurisdiction to affect any notice or order issued under FISA, "*except* as otherwise provided in [12 U.S.C. 1818]." 12 U.S.C. 1818(i)(1) (emphasis added). And 12 U.S.C. 1818(h)(2) expressly provides that any party subject to an order issued after a final decision under FISA may petition for review of that order in the appropriate United States Court of Appeals; the court of appeals then has exclusive jurisdiction to "affirm, modify, terminate, or set aside, in whole or in part, the order of the agency." 12 U.S.C. 1818(h)(2). The court of appeals' misuse of jurisdiction under *Leedom* v. *Kyne* thus circumvents the otherwise fully adequate scheme of judicial review Congress provided in FISA.

Second, this Court has stressed that jurisdiction under *Leedom* v. *Kyne* may not be invoked merely to "review" agency action. Rather, such an exercise of jurisdiction is appropriate only where necessary to remedy action that is manifestly beyond the agency's delegated authority and thus in excess of the agency's jurisdiction. *E.g., Brotherhood of Ry. & S.S. Clerks,* 380 U.S. at 659; *Boire* v. *Greyhound,* 376 U.S. at 481; *Leedom* v. *Kyne,* 358 U.S. at 188. The decision below brushed aside this limitation. Here, the court of appeals acknowledged that the Board's authority to promulgate and enforce its source of strength regulations ultimately turned on application of the framework set forth in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). App., *infra,* 21a-22a. But the very existence of such an issue under the *Chevron* framework presupposes that Congress has not spoken to the precise issue at hand, and that the agency therefore has the jurisdiction and delegated authority to construe the meaning of the statutory provision.[17] For

[17] See, *e.g., K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 292-293 (1988); *Commodity Futures Trading Comm'n* v. *Schor*, 478 U.S. 833, 844 (1986).

that reason alone, invocation of *Leedom* v. *Kyne* is particularly inappropriate and amounts to wholesale circumvention of the congressional scheme for obtaining judicial review of final agency action.

Finally, since jurisdiction under *Leedom* v. *Kyne* is, as this Court recognized, exercised only to prevent an agency's *ultra vires* action from destroying otherwise legally cognizable rights, 358 U.S. at 190, such jurisdiction must be predicated on agency action that has binding legal effect on the aggrieved party. The court of appeals, however, jumped the gun and misapplied *Leedom* in the absence of legally binding agency action. In this case, the Board has only filed notices of charges and initiated administrative proceedings; the Board has neither found that MCorp violated any federal law or regulation, nor has the Board issued a final cease-and-desist order directing MCorp to take any corrective measures. The Board's preliminary steps are not the sort of final agency actions that constitute cognizable legal injury otherwise subject to judicial review. See *Federal Trade Comm'n* v. *Standard Oil Co.*, 449 U.S. 232 (1980). And in the absence of such an injury, *Leedom* v. *Kyne* offers scant support for federal courts to interfere with ongoing administrative proceedings, particularly where, as here, the lawfulness of such proceedings is fully reviewable upon issuance of a final agency decision (and where the statute, by precluding other avenues of judicial review, effectively calls for the exhaustion of administrative remedies).[18]

3. In invalidating the source of strength regulations, the court of appeals misconstrued the Federal Reserve

[18] As the court of appeals correctly determined, in the absence of jurisdiction under *Leedom* v. *Kyne*, 28 U.S.C. 1334 does not otherwise provide jurisdiction to review the Board's initiation of administrative proceedings against MCorp. App., *infra*, 5a-11a.

Board's statutory authority, derived from the Bank Holding Company Act, the Financial Institutions Supervisory Act, and the International Lending Supervision Act, to supervise bank holding companies' activities that may adversely affect bank safety. The decision below is inconsistent with Congress's delegation of supervisory power to the Board and threatens to restrict the Board's delegated authority to exercise continuing control and supervision of bank holding company practices that impair the stability of the Nation's banking system.

a. Turning to the Board's authority under FISA, the court of appeals correctly recognized — as a threshold matter — that "Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies." App., *infra*, 22a; accord *Investment Co. Inst.* v. *FDIC*, 815 F.2d 1540, 1550 (D.C. Cir.), cert. denied, 484 U.S. 847 (1987).[19] Consequently, the Board's conclusion that failure to act as a source of strength to subsidiary banks constitutes an unsafe or unsound practice must be upheld unless it is an unreasonable or impermissible construction of the statute. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. at 844. Contrary to the court of appeals' restrictive analysis, the Board's source of strength policy is a reasonable and sound interpretation of its statutory duty under ~~the~~ FISA to compel bank holding companies to cease and desist from "unsafe or unsound [banking] practices." 12 U.S.C. 1818(b)(1) and (3).

[19] In considering FISA, Congress relied on the memorandum submitted by the then Chairman of the Federal Home Loan Bank Board, John Horne. Chairman Horne, in commenting on the proposed legislation, noted that the term "unsafe or unsound" practice would necessarily have a flexible application adapted to the circumstances of each case. 112 Cong. Rec. 26,474 (1966); see 112 Cong. Rec. 25,007-25,008 (1966).

First, the legislative record surrounding FISA's cease-and-desist authority shows that Congress intended to empower the Board to rectify bank holding company practices that adversely affect the safety and stability of subsidiary banks. As originally enacted in 1966, FISA's authority to remedy unsafe banking practices did not extend to bank holding companies. In 1974, however, Congress expressly brought bank holding companies within the reach of this regulatory power. See Act of Oct. 28, 1974, Pub. L. No. 93-495, Tit. I, § 110, 88 Stat. 1506 (codified at 12 U.S.C. 1818(b)(3)). In reporting out this legislation, the Senate Banking Committee explained that it

> believes that the principal concern of the Federal supervisory agencies in discharging their responsibilities under the Federal law should be with the soundness of affiliated financial institutions. It is clearly in the puiblic interest that these institutions remain sound and viable whether operated independently or as part of a holding company system. The cease and desist authority that the Committee recommends will, among other things, help prevent or terminate practices which might result in significant damage to depositors or to public confidence in the financial system.

S. Rep. No. 902, 93d Cong., 2d Sess. 10 (1974). Accordingly, the Board has acted well within its delegated authority in defining an unsafe bank holding company practice with reference to its impact on affiliated banks.

Second, the Board has reasonably determined that bank holding company activities (or failures to take steps) that allow subsidiary banks' capital reserves to fall below minimally acceptable standards constitute unsafe or unsound banking practices within the meaning of FISA, 12 U.S.C. 1818(b). Subsidiary banks' safety and stability depend, in

large measure, on their capital position. And as this Court has pointed out, "Congress has long regarded capital adequacy as a measure of bank safety." *First Lincolnwood Corp.*, 439 U.S. at 250. For that reason, in ILSA, Congress has authorized the Board—and other federal banking regulatory agencies—to establish minimum capital levels for the banking institutions under their supervision. See 12 U.S.C. 3907(a). Indeed, Congress has made plain that

> [f]ailure of a banking institution to maintain capital at or above its minimum level * * * may be deemed by the appropriate Federal banking agency, in its discretion, to constitute an unsafe and unsound practice within the meaning of [FISA, 12 U.S.C. 1818].

12 U.S.C. 3907(b).

Third, nothing in FISA precludes the Board from determining—as a matter of sound federal banking policy—that bank holding companies, despite their legal status as separate corporate entities, must ultimately remain accountable for the capital adequacy of their subsidiary banks. Had Congress intended that the Board uniformly observe a rigid distinction between holding companies and subsidiary banks, Congress assuredly would not have vested the Board with the power, under FISA, to rectify *holding company* practices that adversely affect *bank* safety.

Moreover, the strict separation of corporate entities demanded by the court of appeals' reasoning, see App., *infra*, 23a-25a, is belied by the economic realities of holding company operations. A holding company's subsidiary banks are—by definition—under the holding company's ownership or control. As expert observers have pointed out, a bank holding company, in some respects, functions as a single economic entity.[20] The holding company may

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[20] For example, the Chairman of the Federal Reserve Board recently told Congress:

well be separately incorporated, but that separate corporate status does not prevent it from deriving considerable economic benefits from its subsidiary banks. Indeed, the holding company derives distinct commercial advantages from control of institutions that, through their power to accept federally insured deposits, have the ability to attract capital and to make profitable loans and investments. The Board's source of strength policy insures that the relationship between the holding company and its banks does not become a one-way street permitting the holding company to derive the full benefit of federal deposit insurance and to maximize its own economic advantage without imposing correlative obligations to preserve bank safety or to prevent injury to depositors and the federal insurance system.

b. The Bank Holding Company Act—particularly its provision empowering the Board to consider the "future prospects" of subsidiary banks when approving acquisitions, 12 U.S.C. 1842(c)—further supports the Board's source of strength regulations. In *First Lincolnwood Corp.*, 439 U.S. at 250-252, this Court held that Section 3(c) of the BHCA, 12 U.S.C. 1842(c), authorizes the Board, when reviewing a proposed bank acquisition, to

> [T]he practical realities of the market place and the internal dynamics of a business organization under central direction drive bank holding companies to act . . . as one business entity, with the component parts drawing on each other for marketing and financial strength. Certainly, the market conceives of a bank holding company and its components in that way. And if market participants tend to consider the bank holding company as an integrated entity, problems in one part of the system will inevitably be transmitted to other parts.

S. Rep. No. 19, 100th Cong., 1st Sess. 9 (1987); see also Mayne, *New Directions in Bank Holding Company Supervision*, 95 Banking L.J. 729, 730-732 (1978).

consider whether a holding company can act as a source of strength to a subsidiary bank. Here, the court of appeals, in light of *First Lincolnwood*, limited the reach of Section 1842(c) to the acquisition stage. See App., *infra*, 18a-21a. That limitation is at odds with the statutory scheme of the BHCA, which vests the Board with broad powers to regulate holding companies' ongoing banking practices.

First, unless the Board can impose on holding companies a *continuing* obligation to act as sources of strength to subsidiary banks, the Board's undisputed power under Section 1842(c) to consider holding companies' resources when reviewing bank acquisitions would have virtually no impact on bank safety.[21] Such a state of affairs would be inconsistent with the mandate of Section 1842(c) that requires the Board to consider the "future prospects" of banks that may come under the holding company's control. Indeed, the Board's express statutory power to base the approval of a bank acquisition on the holding company's ability to protect the capital position of a proposed subsidiary would be nullified if the holding company has no continuing obligation to fulfill that requirement once the bank acquisition is completed.[22]

[21] To be sure, the court of appeals stated that "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial soundness." App., *infra*, 21a n.5. The court's equivocal statement offers the Board little solace, since the Board—under the court's holding—would still lack any statutory basis for enforcing the source of strength policy against the thousands of banks that are already under holding company control.

[22] Although Section 1842(c), by its terms, does not empower the Board to consider the holding company's continuing compliance with the terms and conditions of the acquisition, the Board, under 12 U.S.C. 1844(b), has express authority to "issue such regulations and orders as may be necessary to enable it to administer and carry out the

Second, the entire statutory scheme of the BHCA governing the Board's authority over holding companies reflects Congress's intent that the Board exercise ongoing supervisory powers over holding company operations that affect the stability of subsidiary banks. Accordingly, Congress gave the Board the power to examine the financial transactions and records of each holding company and subsidiary, see 12 U.S.C. 1844(c) – a power this Court has characterized as "perhaps the most effective weapon of federal regulation of banking." *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 329 (1963). In addition, Congress authorized the Board to curtail holding companies' ability to engage in "nonbank" activities that pose risks to the financial stability of subsidiary banks. See 12 U.S.C. 1843, 1844(e). These statutory provisions – among others[23] – show that Congress plainly intended to vest the Board with broad and substantial powers to regulate holding company practices that bear directly on the day-to-day integrity of banking subsidiaries. Cf. *Toilet Goods Ass'n* v. *Gardner*, 387 U.S. 158, 163 (1967). The Board's source of strength regulations thus further Congress's overarching objective of "assur[ing] that financial institutions are not endangered with respect to activities engaged

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purposes of [the BHCA] and *prevent evasions thereof*" (emphasis added). Accordingly, the Board may reasonably regard a holding company's failure to adhere to the requirements governing its initial acquisition as an evasion of the purposes of the BHCA – an evasion that is remediable as an unsafe and unsound banking practice under FISA, 12 U.S.C. 1818(b)(1).

[23] As mentioned above, under ILSA, the Board has authority to establish minimum capital requirements for holding companies where necessary to promote bank safety. See 12 U.S.C. 3907, 3909(a)(2); 12 C.F.R. 263.35-263.40. And under FISA, the Board can order holding companies to cease and desist from engaging in unsafe banking practices. See 12 U.S.C. 1818(b).

in by parent holding companies." S. Rep. No. 902, *supra*, at 10.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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Board of Governors of the Federal Reserve System

DECEMBER 1990

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., AND MCORP,
PLAINTIFFS-APPELLEES AND

OFFICIAL CREDITORS' COMMITTEE OF MCORP, MCORP
FINANCIAL, INC., AND MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

**APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS**

May 15, 1990

Before: GARZA, WILLIAMS and DAVIS, *Circuit Judges*.

W. EUGENE DAVIS, *Circuit Judge*:

The Board of Governors of the Federal Reserve appeals an order of the district court sitting in bankruptcy, enjoining the Board from pursuing its enforcement actions against MCorp without district court approval. 101 B.R.

483. Because the Board's source of strength proceedings exceed its statutory authority, we remand with instructions to enjoin the Board from further prosecution of these charges. Because the district court lacks subject matter jurisdiction to enjoin the Board's actions on the remaining charges, we vacate the injunction as to these charges.

I.

In October 1988, the Board of Governors of the Federal Reserve (the Board), the primary regulator for bank holding companies, issued a notice of charges and of hearing against MCorp, a Texas-based bank holding company. The Board alleged that MCorp was engaging in unsafe and unsound practices, "likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the subsidiary Banks." A week later the Board issued an Amended Notice of Charges, which sought, among other things, to require MCorp to "implement[ ] an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies." MCorp's subsidiary banks were suffering heavy losses from real estate and energy loans.

In March 1989, three creditors of MCorp commenced an involuntary bankruptcy proceeding against MCorp in the U.S. Bankruptcy Court for the Southern District of New York. The Comptroller of the Currency (OCC), the primary regulator for national banks, subsequently declared a total of twenty of MCorp's subsidiary banks (MBanks) insolvent; OCC appointed the Federal Deposit Insurance Corporation (FDIC) as receiver, divesting MCorp of control of these banks. MCorp was left with five banks. MCorp and two of its subsidiaries, MCorp

Financial and MCorp Management then filed voluntary Chapter 11 bankruptcy petitions in the U.S. Bankruptcy Court for the Southern District of Texas. The bankruptcy proceedings against MCorp and its subsidiaries (hereafter collectively referred to as MCorp) were consolidated into one jointly administered proceeding in the Texas forum.

In March 1989, by notice of charges and hearing the Board also commenced further administrative proceedings against MCorp. The March charges accused MCorp and MCorp management of violations of § 23A of the Federal Reserve Act, alleging MCorp caused MBank Houston and MBank Preston, two of the closed banks, to provide MCorp management "unsecured extensions of credit." In late May the Board issued a second amended notice of charges, relating to the October notice of charges, alleging that MCorp had failed to act as a source of financial strength to its remaining subsidiary banks.

MCorp initiated an adversary proceeding against the Board in May 1989, and filed an Emergency Motion for a TRO and preliminary injunction, seeking to enjoin the Board from prosecuting its administrative proceedings against the debtors, and from initiating further administrative proceedings against the debtors without prior approval of the bankruptcy court. The bankruptcy court denied the TRO request. The Board moved the district court to withdraw the reference of the adversary proceeding to the bankruptcy court. The district court granted the Board's motion and placed the case on its own docket.

In June 1989, the district court entered a preliminary injunction granting the relief sought by the debtors. The district court preliminarily enjoined the Board from prosecuting its pending administrative proceedings and

> using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components

> or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

The district court stated that the preliminary injunction left completely unaffected the Board's "general execution, supervisory and examination duties of the operations of MCorp and its bank subsidiaries and . . . central bank duties as they affect MCorp in common with all other institutions." The court established a procedure for future Board proceedings, where the Board was first required to present to MCorp any new administrative proceedings, notices of charges or temporary cease and desist orders before their issuance. If the Board and MCorp could not agree whether a proposed proceeding was subject to the preliminary injunction, the Board could then present that issue to the district court. If the court decided the Board's proposed action related to the banks' "operations," the court proposed to exempt this action from the restraint of the preliminary injunction; if however the Board's proposed action affected the reorganization, the district court proposed to stay this action in deference to the bankruptcy court.

The Board appealed the preliminary injunction to this court.

II.

A.

The Board contends first that the district court, sitting in bankruptcy, has no jurisdiction to enjoin the Board's prosecution of its administrative actions, because of 12 U.S.C. § 1818(i)(the Financial Institutions Supervisory Act of 1966 (FISA) as amended), which provides:

> except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

As we stated in *Groos National Bank v. Comptroller of Currency,* 573 F.2d 889 (5th Cir.1978), "section 1818(i) in particular evinces a clear intention that this regulatory process is not to be disturbed by untimely judicial intervention, at least where there is no 'clear departure from statutory authority.' " *Id.* at 895, *quoting Manges v. Camp,* 474 F.2d 97, 99 (5th Cir.1973). Thus, under 12 U.S.C. § 1818(h) and the Administrative Procedure Act (APA), a bank holding company is not ordinarily entitled to judicial review until the Board issues a final order.

MCorp's principal argument that the district court properly exercised subject matter jurisdiction is predicated on 28 U.S.C. §§ 1334(b) and (d). MCorp argues that these sections of the Bankruptcy Code effectively supersede the Board's exclusive jurisdiction under § 1818(i)(1) to prosecute its enforcement actions, and therefore empower the court to enjoin prosecution of those actions. The district court presumably agreed and concluded that § 1818(i) conflicted with §§ 1334(b) and (d) of the Bankruptcy Code.

Section 1334(b) provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

The plain language of § 1334(b) does not purport to give the district court exclusive jurisdiction over matters arising under Title 11 to the exclusion of administrative agencies; rather, § 1334(b) grants the district court concurrent

jurisdiction over matters that otherwise would lie within the exclusive jurisdiction of another court.

The legislative history of § 1334(b) also supports the view that the section was intended to prevent another court from exercising exclusive jurisdiction over a matter brought within the Bankruptcy Code. The Commission on the Bankruptcy Laws of the United States, quoted at length in the House Judiciary Committee report, stated that "[the] first and most important objection to the present dispensation is the division of labor between the bankruptcy court and other courts." H.R.Rep. No. 595, 95th Cong., 1st Sess. 43 (1977), U.S.Code Cong. & Admin.News 1978, pp. 5787, 6005. Under the prior bankruptcy law, the jurisdiction of the bankruptcy court was limited by the concepts of possession and consent. The House report adopted the reasoning of the Commission that the old law was undesirable because of "the frequent, time-consuming, and expensive litigation of the question whether the bankruptcy court has jurisdiction of a particular proceeding." *Id.* at 45, U.S.Code Cong. & Admin.News 1978, p. 6007. Under the prior jurisdictional scheme, " 'When a "summary" proceeding in the bankruptcy court is appropriate and when a plenary suit is required is one of the most involved and controversial questions in the entire field of bankruptcy,' " the Committee observed. *Id.* at 45, U.S.Code Cong. & Admin.News 1978, p. 6007. We are persuaded therefore that it was this division of jurisdiction between bankruptcy courts and *other courts* which the jurisdictional changes of the new law were intended to address.

MCorp argues that the legislative history explains that § 1334(b) grants bankruptcy courts pervasive jurisdiction over all matters and proceedings that arise in or in connection with bankruptcy cases. Yet the legislative history

reflects no intent that the bankruptcy court's jurisdiction supersede the exclusive jurisdiction of an administrative jurisdiction barred by § 1818.

In holding that § 1334 superseded § 1818(i), the district court did not harmonize the two statutes, but effectively repealed § 1818(i), and negated its basic sense and purpose of preventing early interference with administrative proceedings. This interpretation invested the district court, sitting in bankruptcy, with equitable power withheld from every other court by the language of § 1818(i). Implied repeals are highly disfavored, one statute will not be considered to impliedly repeal another unless there is a "positive repugnancy" between the two. *Tennessee Valley Authority v. Hill,* 437 U.S. 153, 189-190, 98 S.Ct. 2279, 2299-2300, 57 L.Ed.2d 177 (1978). We find no such irreconcilable conflict here. As the Supreme Court has stated:

> The "plain purpose" of legislation . . . is determined in the first instance with reference to the plain language of the statute itself. Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard-fought compromises.

Board of Governors v. Dimension Financial Corp., 474 U.S. 361, 373-74, 106 S.Ct 681, 688-89, 88 L.Ed.2d (1968)(citation omitted).

MCorp further contends that courts consistently have held that the phrase in § 1334(b), "[notwithstanding] any

act of Congress that confers exclusive jurisdiction on [any other] court," was expressly intended to confer on the bankruptcy courts jurisdiction over all matters related to a debtor's Chapter 11 case, including administrative proceedings, citing *In re Casey Corp.*, 46 B.R. 473 (S.D.Ind.1985), and *In re Shelby County Healthcare Services of Al., Inc.*, 80 B.R. 55 (N.D.Ga.1987). The district court relied in part upon *Casey* in holding that § 1334 superseded the jurisdictional bar of § 1818(i). These cases are not binding upon this court, however, nor do we find their reasoning persuasive as to the issue before us.

MCorp argues next that the bankruptcy court has exclusive jurisdiction over the Board's enforcement proceeding based on § 1334(d), which provides:

> The district court in which a case under title 11 is commenced or is pending shall have *exclusive* jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate. (emphasis added).

According to MCorp, because the bankruptcy court has exclusive control of MCorp's assets, it necessarily follows from the above section that the Board had no jurisdiction over MCorp. But the Board has not sought control over the property of MCorp's estate in this action, only the opportunity to go forward in its administrative proceedings. Nor at this early stage do we find the Board's enforcement actions to be sham proceedings, brought as a means of controlling the debtor's assets. We therefore do not consider § 1334(d) to grant the district court exclusive jurisdiction here.

MCorp relies on *In re Modern Boats, Inc.*, 775 F.2d 619 (5th Cir.1985), and *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985), to support its argument. *Louisiana Ship Management* and *Modern Boats* both

involved in rem proceedings in admiralty where vessels were under seizure. We held that once a chapter 11 petition was filed, the court where that petition was filed enjoyed exclusive jurisdiction over the vessels subject to a maritime lien and that the admiralty court had no jurisdiction over the property. MCorp's reliance on these cases is misplaced because the Board's proceedings do not directly concern the debtor's property.

MCorp also argues that because the above Bankruptcy Code provisions were enacted after § 1818, and do not exempt bank holding company administrative actions from the comprehensive jurisdiction of the bankruptcy court, Congress must have intended no such exemptions. MCorp contends that this is especially true in view of the express exemption granted banks from recourse to bankruptcy protection in § 109 of the Bankruptcy Code. Absent some clear intention to the contrary, however, a specific statute will not be controlled by a general one regardless of the priority of enactment. *Crawford Fitting Co. v. J.T. Gibbons. Inc.*, 482 U.S. 437, 107 S.Ct. 2494, 96 L.Ed.2d 385 (1987). Congress revealed no intent to supersede the specific jurisdictional bar of § 1818(i) in the legislative history of the Bankruptcy Reform Act, nor in the recently enacted Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub.L. No. 101-73, 103 Stat. 183. We decline to imply any affirmative powers to the bankruptcy court from Congress' failure to act in this area.

In analogous circumstances, several circuits have held that the automatic stay provisions of the Bankruptcy Code in the case of a bankrupt employer do not supersede the anti-injunction provision of the Norris-LaGuardia Act, which precludes courts from enjoining union conduct. In *In Re Crowe & Associates. Inc.*, 713 F.2d 211, 214-16 (6th Cir.1983), the Sixth Circuit concluded that the legislative

history of the Bankruptcy Reform Act was silent as to the anti-injunction provisions of the Norris-LaGuardia Act, and this silence was "self-evident proof that Congress never intended to supersede or transcend [the Norris-LaGuardia Act], since we cannot believe that the Norris-LaGuardia Act was to be superseded *sub silentio.*" *Id.* at 215, *quoting In re Petrusch,* 667 F.2d 297, 300 (2d Cir. 1981); *see also Briggs Transportation Co. v. International Brotherhood of Teamsters,* 739 F.2d 341, 343 (8th Cir.1984)("the parties have cited us to nothing in the Bankruptcy Code or its legislative history indicating a congressional intent to lift the jurisdictional restrictions of the Norris-LaGuardia Act").

The Board also relies on *Becker's Motor Transportation, Inc. v. Needham's Motor Service, Inc.*, 632 F.2d 242 (3d Cir.1980), *cert. denied,* 450 U.S. 916, 101 S.Ct. 1358, 67 L.Ed.2d 341 (1981), in which the court held independent statutory provisions barring any suit to restrain the assessment or collection of taxes deprived the bankruptcy court of the authority to enter an injunction against the government's tax collection efforts. In reaching this conclusion the Third Circuit in *Becker's Motor* distinguished *Bostwick v. United States,* 521 F.2d 741 (8th Cir.1975), a tax injunction case relied upon by MCorp and the lower court in which the Eighth Circuit reached the contrary result. The court in *Becker's Motor* concluded that the *Bostwich* court created a judicial exception to the tax anti-injunction statute in contravention of clear congressional intent. *Becker's Motor,* 632 F.2d at 246. We agree with the Third Circuit that absent clear congressional intent any argument for permitting the bankruptcy court's jurisdiction to supersede existing anti-injunction legislation should be addressed to Congress, and we will not imply the repeal of such legislation.

For the above reasons, we conclude that the plain language of § 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings if the Board's actions do not exceed the authority Congress granted to it. We turn next to MCorp's argument that the Board is exceeding its statutory authority.

B.

MCorp asserts that the Board lacks authority to proceed against banks in FDIC receivership, that the Board's self-dealing charges are a pretext for avoiding the exclusive jurisdiction of the bankruptcy court over MCorp's assets, and that the Board's source of strength policy is without statutory authority.

In *Manges v. Camp,* 474 F.2d 97 (5th Cir.1973), we recognized that the statute at issue here, § 1818, that withdraws the jurisdiction of the court in deference to an agency, is not effective when the agency exceeds its authority under that statute. There is "a very strong court created exception to withdrawal statutes. This exception comes into play when there has been a clear departure from statutory authority, and thereby exposes the offending agency to review of administrative action otherwise made unreviewable by statute." *Manges,* 474 F.2d at 99. If the Board's proceedings exceed its statutory authority, we may review the Board's action prior to a final order despite the jurisdictional bar of § 1818; if the Board "was not acting within [the] authority granted by Congress, then 12 U.S.C. § 1818(i) could not withdraw jurisdiction." *Manges,* 474 F.2d at 99.

The Supreme Court established this exception in *Leedom v. Kyne,* 358 U.S. 184, 79 S.Ct 180, 3 L.Ed.2d 210 (1958). In *Leedom* the Court found district court review proper, despite an express preclusion provision,

where the National Labor Relations Board had acted in excess of its delegated powers.

The Court stated in *Leedom* that "[t]his suit is not one to 'review,' in the sense of that term as used in the [National Labor Relations] Act, a decision of the [National Labor Relations] Board made within its jurisdiction. Rather it is one to strike down an order of the Board made in excess of its delegated powers. . . ." *Leedom,* 358 U.S. at 188, 79 S.Ct. at 183. The D.C. Circuit recently characterized the *Leedom* rule as one permitting a court in the face of a withdrawal statute to determine "whether an agency has acted 'in excess of its delegated powers' " and "whether the agency action 'on its face' violated a statute." *Dart v. United States,* 848 F.2d 217, 222 (D.C.Cir.1988). *See Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp.,* ____ U.S. ____, 109 S.Ct. 1361, 103 L.Ed.2d 602 (1989); *Breen v. Selective Service Local Board,* 396 U.S. 460, 90 S.Ct. 661, 24 L.ed.2d 653 (1970); *Oestereich v. Selective Service System Local Board,* 393 U.S. 233, 89 S.Ct. 414, 21 L.Ed.2d 402 (1968). *Cf. Bowen v. Michigan Academy of Family Physicians,* 476 U.S. 667, 680 n. 11, 106 S.Ct. 2133, 2141 n. 11, 90 L.Ed.2d 623 (1986).

MCorp argues that the Board exceeded its authority in three respects because it has no authority to (1) regulate MCorp's relationships with *former* MBanks, now under FDIC receivership, which are the subject of the administrative proceedings; (2) assist the FDIC, as receiver of the closed MBanks, to obtain damages under the pretext of punishing MCorp for violations of § 23A of the Federal Reserve Act[1] which concerns self-dealing among

[1] Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, prohibits a bank from extending credit to a nonbank affiliate unless the extension of credit is secured by collateral having a market value of at

holding company subsidiaries; and (3) compel a bank holding company to transfer its funds to subsidiary banks.

MCorp argues first that the Board lacks authority to regulate MCorp's relationships with former subsidiary banks now under FDIC receivership. Both the "source of strength" charges and the self dealing charges, as initially set out by the Board, were levelled in part to the relationship between MCorp and MBanks which were later closed and placed under FDIC receivership. We are persuaded that the Board is at least entitled to make a determination on the legitimacy of the credit transaction with the closed banks at issue to allow it to evaluate what remedy it wants to pursue against MCorp. Certainly the Board's attempt to do that is not facially invalid.

MCorp next argues that the Board's § 23A proceeding is simply an attempt to assist the FDIC to obtain MCorp's property under the guise of remedying a violation of § 23A of the Reserve Act. We disagree. The Board is well within its authority in seeking an order against MCorp to cease and desist any transactions which violate the provisions of § 23A, or "to take affirmative action" as may be appropriate. 12 U.S.C. § 1818(b)(1). The notice of charges relating to the appropriateness of the credit transactions between an MCorp nonbank subsidiary and two of MCorp's former subsidiary banks is not on its face a sham proceeding initiated only to assist the FDIC to collect damages; at least a fact issue is presented on the merits of the § 23A charges. The mere prosecution of the charges before the Board does not in itself disturb the bankruptcy

least 100 percent of the loan. The Board has charged that MCorp violated this requirement by causing two of its former subsidiary banks to extend $63.7 million of unsecured credit to an affiliated subsidiary of MCorp, and failing to make timely repayments to the subsidiary banks that extended the credit.

court's alleged exclusive jurisdiction over MCorp's property under § 1334(d).

We are persuaded, however, that a serious legal issue is presented as to whether the Board has statutory authority to pursue its source of strength charges. Before turning to that problem, we address a threshold argument of the Board that we are precluded from considering the Board's authority to proceed.

The Board contends that MCorp may not judicially challenge at this stage the Board's authority to proceed with its charges because MCorp has not exhausted its administrative remedies. The Board relies on *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 58 S.Ct. 459, 82 L.Ed. 638 (1938), in which the Court stated that "[j]udicial relief is not normally available for supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Id.* at 50, 58 S.Ct. at 463.

Myers did not present a challenge to the agency's authority to act on the complaint presented to it. The petitioning employer factually challenged the interstate nature of the employer's business, one of the elements of the NLRB's charge. The Court concluded that this factual determination should be made by the NLRB. The Supreme Court held that a federal district court is without jurisdiction to enjoin the NLRB from "hearing and determining what Congress declared the [National Labor Relations] Board should hear and determine in the first instance." *Id.* at 50-51, 58 S.Ct. at 463-464 (footnote omitted).

The question of the Board's authority to impose its source of strength requirement is quite a different issue. No facts are in dispute. The sole question presented is a legal one: whether the Board has authority to order a holding company to transfer its funds to its troubled subsidiary banks. The Board has instituted proceedings to require that holding company to transfer those funds. The legal issue of the Board's authority can be resolved without further factual development. "[P]rompt resolution will eliminate uncertainty and be in the interest of efficient judicial administration." *Indep. Bankers Ass'n v. Heimann,* 613 F.2d 1164, 1167 (D.C.Cir.1979), *cert. denied,* 449 U.S. 823, 101 S.Ct. 84, 66 L.Ed.2d 26 (1980). Because we conclude that MCorp is not required to exhaust its administrative remedies in this circumstance, we turn to the merits of whether the Board has authority to require the holding company to transfer its funds to troubled subsidiary banks.

The Board contends it has authority to issue the source of strength charges under §§ 1818(b)(1) and (3), which empower it to file charges against a bank holding company which the Board believes (1) has violated or is about to violate a "law, rule or regulation"; or (2) is engaging in an "unsafe or unsound" practice.[2] The Board contends that

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[2] Termination of status as insured depository institution, Section 1818 which is captioned in § (b)(1) and (3):

> (b) Cease-and-desist proceedings
>
> (1) If, in the opinion of the appropriate Federal banking agency, any insured depository institution . . . is engaged or has engaged, or the agency has reasonable cause to believe that the depository institution . . . is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated, or the agency has reasonable cause to believe that the depository institution or any institution-affiliated party is about to violate, a law, rule, or regulation . . . the agency may issue and serve upon the depository institution or such party a notice of charges in respect thereof. . .
>
> (3) This subsection . . . shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956. . . . Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency, other

MCorp has failed to act as a source of strength for its bank subsidiaries in violation of the Board's regulations and policy statements. The Board also contends that this failure constitutes an unsafe or unsound practice in violation of § 1818.[3]

We consider first whether the authority the Board assumed under its regulation and policy statement exceeds its statutory grant. The Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. § 1841 et seq., grants the Board supervisory control over the formation, structure and operation of bank holding companies and their nonbank subsidiaries. Section 3(a) of the Act, 12 U.S.C. § 1842(a), provides that no company may acquire control of a bank without prior approval by the Board. In determining whether to approve an application, § 3(c) of the Act, 12 U.S.C. § 1842(c), directs the Board to consider "the financial and managerial resources and future prospects of the company or companies and the banks concerned."[4]

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than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank).

12 U.S.C. §§ 1818(b)(1) and (3), *amended by* FIRREA, Pub.L. No. 101-73, §§ 901(d), 902(a)(1)(A).

[3] Because we conclude that the source of strength proceedings exceed the Board's statutory authority, we need not resolve whether the source of strength charges relating to MCorp's former subsidiary banks are beyond the Board's authority.

[4] Section 1842 states in relevant part:

Acquisition of bank shares or assets

* * *

(c) Factors governing determination of application for approval

. . .

In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

In 1984, as part of its comprehensive revision of Regulation Y, the Board added 12 C.F.R. § 225.4(a)(1), which provides:

> § 225.4 Corporate practices.
>
> (a) *Bank holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and mangerial strength to its subsidiary banks and shall not contuct [*sic*] its operations in an unsafe or unsound manner.

Revision of Regulation Y, 49 Fed.Reg. 820 (1984) (codified at 12 C.F.R. § 225.4(a)(1)).

In April 1987, the Board published a policy statement in the Federal Register, which further provided:

> It is the policy of the Board that in serving as a source of strength to its subsidiary banks, *a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks* during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. . . .
>
> A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary bank(s), including an unwillingness to provide appropriate assistance to a troubled or failing bank, will generally be considered an unsafe and unsound banking practice or a violation of Regulation Y, or both. . . .

Policy Statement, 52 Fed.Reg. 15707, 15708 (1987) (emphasis added). This policy statement was effective April 24, 1987. The Board solicited comments on the policy, with a view to revising the statement in light of such comments. No subsequent revision has been published.

The Board also relies on the broad language of § 5(b) of the BHCA, 12 U.S.C. § 1844(b), for authority to issue the above regulation and policy statement. Section 5(b) states:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.

The Board finds support for its authority to enforce its source of strength requirements in *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, 99 S.Ct. 505, 58 L.Ed.2d 484 (1978). In this case the Court considered whether the BHCA authorized the Board to disapprove an application of a proposed bank holding company solely on grounds of financial unsoundness, and in the absence of any anticompetitive effects resulting from the transaction. The Supreme Court answered this question in the affirmative and upheld the Board's rejection of a proposed holding company's application. This holding was based on the statutory language of 12 U.S.C. § 1842(c), as well as the legislative history of the BHCA. The Supreme Court stated:

> The language of the statute supports the Board's interpretation of § 3(c) as an authorization to deny applications on grounds of financial and managerial unsoundness even in the absence of any anticompetitive impact. Section 3(c) directs the Board to consider the financial and managerial resources and future prospects of the applicants and banks concerned "[i]n every case," not just in cases in which the Board finds that the transaction will have an anticompetitive effect.

Id. at 243, 99 S.Ct. at 510.

In response to the court of appeals' holding that the Board's authority to deny an application because of unsound financial or managerial consideration was limited to instances in which the unsoundness was caused or exacerbated by the proposed transaction, the Court stated:

> Indeed, the Court of Appeals' construction of the statute would require the Board to approve formation of a bank holding company with corrupt management simply because management would become no more corrupt by virtue of the transaction. We hesitate to adopt a construction that would yield such an anomalous result.

Id. at 250, 99 S.Ct. at 514.

Finally, addressing the arguments of the dissent, the Court stated that its holding was not intended to extend the Board's authority to day-to-day supervision of banks, but allowed the Board to disapprove an application to prevent the formation of an unsound holding company.

> In the dissent's view, the Board, by looking beyond the transaction before it, attempted to exercise the day-to-day regulatory authority over banks which Congress denied to it and conferred on the Comptroller. We disagree with the basic premise of the dissent's argument. As the Board found, the *effect* of this transaction would have been the formation of a financially unsound bank holding company. Thus, the Board's attempt to prevent this effect and to induce respondent to form an enterprise that met the Board's standards of financial soundness was entirely consistent with the language the dissent cites.

Id. at 252 n. 18, 99 S.Ct. at 515 n. 18 (emphasis added). In *First Lincolnwood,* therefore, the Court relied upon the express provisions of § 3(c) that required the Board to consider financial soundness of the subsidiary bank in determining whether to approve a holding company's application. The Court made it clear that it did not read the

BHCA to grant the Board authority to regulate the day-to-day financial soundness of the subsidiary banks.

The Supreme Court in *Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361, 106 S.Ct. 681, 88 L.Ed.2d 691 (1986), considered whether the Board exceeded its authority in expanding certain definitions in Regulation Y. The Board, as part of Regulation Y, included institutions that were not banks within the Board's regulatory ambit. The Court concluded that the Board had exceeded its authority in attempting to regulate the "non-bank banks."

The Court found that the BHCA "vests broad regulatory authority in the Board over bank holding companies 'to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit.' " *Id.* at 365, 106 S.Ct. at 684, *quoting* S.Rep. No. 91-1084 (1970), U.S.Code Cong. & Admin.News 1970, p. 5541. The Board's new definitions did not fall within the plain purposes of the BHCA, the Court concluded. The Court added that "§ 5 only permits the Board to police within the boundaries of the Act. . . ." *Id.* at 373 n. 6, 106 S.Ct. at 688 n. 6.

First Lincolnwood and *Dimension Financial* together teach that the primary purposes of the BHCA are to prevent the concentration of control of banking resources, and to separate banking from non-banking enterprises. *First Lincolnwood* is narrowly written and expressly limits the Board's authority to consider financial and managerial soundness of subsidiary banks to the Board's decision to grant or deny a holding company's application. Section 3(c) of the BHCA specifically grants this authority to the Board. The BHCA does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application, and *First Lincolnwood* finds this regulatory authority lacking

in the day-to-day operations of a subsidiary bank. For these reasons, we conclude that the Board is without authority under the BHCA to require MBank to transfer its funds to its troubled subsidiary bank.[5]

The Board asserts as an independent basis for its source of strength regulation, policy statement and enforcement proceedings its broad authority under § 1818(b)(1) and (3) of FISA to order a holding company to cease and desist from any activity that, in the Board's judgment, constitutes an unsafe or unsound practice. The Board argues that MCorp's failure to provide capital to its subsidiary banks is an unsafe or unsound practice which the Board may act to restrain under § 1818.

In determining whether we should accept the Board's interpretation of a statute the Board is charged with enforcing, we look to the test established by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense*

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[5] As a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial soundness. The Federal Home Loan Bank Board (FHLBB) has long followed this practice in approving savings and loan holding company applications; in 1981, we approved the practice in *Kaneb Services, Inc. v. Federal Sav. & Loan Ins. Corp.*, 650 F.2d 78 (5th Cir.1981). The statutory authority of the FHLBB to regulate savings and loan holding companies is practically identical to the authority granted the Board to regulate bank holding companies. *See* 12 U.S.C. §§ 1730(e)(1) and (3), 1730a(e)(2); Regulatory Capital Maintenance Obligations of Acquirers of Insured Institutions, 53 Fed.Reg. 31761 (1988); Acquisition of Control of Insured Institutions, 54 Fed.Reg. 32959 (1989)(to be codified at 12 C.F.R. § 574.7(a)(1) and (3)). The Office of Thrift Supervision, the successor to the FHLBB as primary regulator of savings and loan holding companies after FIRREA, continues this practice in its current regulations. *See* Transfer and Recodification of Regulations Pursuant to Financial Institutions Reform, Recovery and Enforcement Act, 54 Fed.Reg. 49411 (1989).

Council, Inc. 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

> If Congress has spoken clearly to the issue presented in a case, that intent controls. 467 U.S. at 844 [104 S.Ct. at 2782]. If the agency's interpretation is contrary to the clear intent of Congress, the agency's interpretation is invalid. If, on the other hand, Congress has no clear intent as to the particular question at issue, the courts may invalidate the agency's interpretation only if it is "unreasonable" or "impermissible." *Id.*

Investment Co. Institute v. Federal Deposit Ins. Corp., 815 F.2d 1540, 1546 (D.C.Cir.), *cert. denied*, 484 U.S. 847, 108 S.Ct. 143, 98 L.Ed.2d 99 (1987). *See also American Insurance Assoc. v. Clarke*, 865 F.2d 278, 280-81 (D.C.Cir.1988).

The Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies. As we stated in *Groos Nat'l Bank v. Comptroller of Currency*, 573 F.2d 889, 897 (5th Cir. 1978), "[t]he phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies." Thus, under the *Chevron* analysis, in the absence of clear congressional intent on the meaning of this language, we must examine the "reasonableness" and "permissibility" of the Board's interpretation that the failure of the holding company to inject capital into subsidiary banks is an "unsafe or unsound" practice.

In *Gulf Federal Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259 (5th Cir.1981), *cert. denied*,

458 U.S. 1121, 102 S.Ct. 3509, 73 L.Ed.2d 1383 (1982), the Federal Home Loan Bank Board found that Gulf Federal's contracting practice was an "unsafe or unsound" practice within the meaning of § 1818. We disagreed and concluded that the FHLBB's finding that Gulf Federal's use of inconsistent contract terms was an unsafe or unsound practice was not a reasonable interpretation of the "unsafe or unsound practice" provision.

We also noted in *Gulf Federal* that the "unsafe or unsound practice" provision was the subject of lively congressional debate at the time the statute was enacted. We observed that the authoritative definition of an unsafe or unsound practice, adopted in both Houses, was that:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

Id. at 264, *quoting* 112 Cong.Rec. 26474 (1966). *See* 112 Cong.Rec. 24984, 26474 (1966).

Enforcement of the Board's source of strength regulation requiring MCorp to transfer MCorp's funds to the troubled subsidiary banks can hardly be considered a "generally accepted standard[ ] of prudent operation." Such a transfer of funds would require MCorp to disregard its own corporation's separate status; it would amount to a wasting of the holding company's assets in violation of its duty to its shareholders. Also, one of the fundamental purposes of the BHCA is to separate banking from commercial enterprises. That purpose is obviously not served if the Board is permitted to treat a holding company as merely an extension of its subsidiary bank.

Congress first under the BHCA in 1956 and later in amendments to the Federal Reserve Act in 1966 has generally defined with specificity the dealings between subsidiary banks and nonbank affiliates, including holding companies, it considered unsafe and unsound. *See* Bank Holding Company Act of 1956, c. 240, § 6, 70 Stat. 137, *repealed by* Pub.L. No. 89-485, § 9, 80 Stat. 240 (1966); Pub.L. No. 89-485, § 12(a)(amending 12 U.S.C. § 371c). *See also* S.Rep. No. 1179, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.Code cong. & Admin.News 2394-96. Congress made no effort in any of this legislation to require holding companies to make capital injections into subsidiary banks as part of these safeguards. Congress noted only that the provision enacted as part of the BHCA "does not prohibit the borrowing of funds by any subsidiary in the system from the parent bank holding company." S.Rep. No. 1095, 84th Cong., 1st Sess., *reprinted in* 1956 U.S.Code Cong. & Admin.News 2482, 2496. In sum, Congress set forth detailed limits on transactions considered unsound between subsidiary banks and holding companies, without mentioning the infusion of capital by holding companies into subsidiaries. This strongly supports MCorp's argument that Congress never intended to grant authority to the Board to require a holding company to inject capital into subsidiary banks as a safeguard against "unsafe or unsound" practices.

This is consistent with the conclusion reached by the Shadow Financial Regulatory Committee,[6] responding to the Board's source of strength policy. The Committee

[6] Formed in February 1986, the Shadow Financial Regulatory Committee (SFRC) meets periodically to monitor regulations of the financial services industry. The SFRC is composed of economists, academics and former financial regulators.

stated that, "while Congress has empowered regulators of banks to issue capital directives to institutions in their charge, it has not authorized the Fed to issue capital directives to bank holding companies." 48 Banking Rep. (BNA) No. 21, at 923 (May 25, 1987).

Thus, we conclude that the Board's determination that the holding company's failure to transfer its assets to a troubled subsidiary was an "unsafe or unsound practice" under §§ 1818(b)(1) and (3) is an unreasonable and impermissible interpretation of that term.

It is not our role to pass judgment on the wisdom of the scheme Congress put in place to regulate bank holding companies. Similarly, the Board cannot exceed the authority Congress granted to it to correct perceived flaws in the congressional scheme. As the Supreme Court stated in *Dimension Financial:*

> The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute.
>
> If the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the Courts, to address.

474 U.S. at 374, 106 S.Ct. at 688-689 (footnote omitted).[7]

[7] The Board also asserts on appeal that its administrative proceedings are exempt from both the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362(b), and the general equitable power of the bankruptcy court under § 105 of the Code. Because we find that the district court, sitting in bankruptcy, lacks jurisdiction over the Board's ongoing enforcement actions, we need not address MCorp's argument that the Bankruptcy Code's stay provisions prevent the Board from proceeding.

III.

Because we find that the Board's source of strength proceedings exceed its statutory authority, we remand this case to the district court with instructions to enjoin the Board from further prosecution of this charge. The remaining preliminary injunction entered by the district court is vacated because it lacked subject matter jurisdiction to interfere with the Board's § 23A proceedings.

REVERSED, VACATED and REMANDED.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., AND MCORP,
PLAINTIFFS-APPELLEES AND

OFFICIAL CREDITORS' COMMITTEE OF MCORP, MCORP FINANCIAL, INC., AND MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS

[Filed Aug. 6, 1990]

ON PETITION FOR REHEARING AND SUGGESTIONS FOR REHEARING EN BANC

Before: GARZA, WILLIAMS and DAVIS, *Circuit Judges.*

PER CURIAM:

(X) The petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestions for Rehearing En Banc are DENIED.

( ) The Petition for Rehearing is DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestions for Rehearing En Banc are also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor of it, rehearing en banc is DENIED.

ENTERED FOR THE COURT:

/s/ W. EUGENE DAVIS
United States Circuit Judge

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civ. A. No. 89-1677
Bankruptcy No. 89-02312-H3-11
Adv. No. 89-0298

IN RE MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS.

MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS, AND OFFICIAL CREDITORS' COMMITTEE, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed June 19, 1989]

OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM

HUGHES, *District Judge*.

1. ***Introduction.***

As debtor in possession, a bank holding company and two of its nonbank subsidiaries (MCorp, MCorp Finan-

cial, Inc., and MCorp Management [Debtor]) applied for a preliminary injunction against the Board of Governors of the Federal Reserve System (Board). The Debtor seeks to enjoin the Board from prosecuting administrative proceedings against the holding company and its nonbank subsidiaries as part of the Board's regulation of the safety and integrity of the bank subsidiaries. The issue is whether a nonbank corporation that owns banks and nonbanks as subsidiaries is entitled to have its bankruptcy case principally directed by the banking agencies or by the bankruptcy process. An injunction will be issued to allow possible reorganization of the Debtor through the bankruptcy court.

2. *Statutes.*

The Debtor asserts:

A. This court sitting in bankruptcy has exclusive jurisdiction over all the property in the debtor's estate. 28 U.S.C. § 1334(d);

B. The Board's actions are in reality an attempt to control the assets of the estate in violation of the automatic stay. 11 U.S.C. § 362(a).

C. If the Board is exempt from the automatic stay, the bankruptcy code authorizes an injunction to protect the debtor from third-party interference. 11 U.S.C. § 105.

The Board counters:

A. The Financial Institutions Supervisory Act (FISA) withdraws jurisdiction from the courts, superseding the automatic stay imposed by the bankruptcy code. 12 U.S.C. § 1818(i).

B. The Board's proceedings are regulatory actions exempted from the automatic stay. 12 U.S.C. § 1818(b); 11 U.S.C. § 362(b).

C. The character of the regulation and the general scheme of banking supervision are not the third-party acts that should be subject to an injunction against interference with a bankruptcy case.

3. *Background of the Controversy.*

At the beginning of 1989, MCorp was a bank holding company, owning twenty-five bank subsidiaries and several nonbank subsidiaries. In common with many financial institutions, MCorp has suffered large, continuing losses from its real estate loans, having already written down its bad oil-related loans. In March, the comptroller of the currency declared twenty of MCorp's banks insolvent and closed them. The banks continued to operate as nationalized receiverships through the Federal Deposit Insurance Corporation under the name Deposit Insurance Bridge Bank.

This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp, and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp and it was transferred here to pend under Case Number 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

The filing in New York of the involuntary case precipitated the bank closings by the comptroller and the volun-

tary cases by the subsidiaries. The Official Creditors' Committee of the debtors was allowed to intervene to assert essentially the same grounds as MCorp in support of an injunction.

MCorp is left with five bank subsidiaries and all of its nonbank subsidiaries, two of which are also debtors in bankruptcy. MCorp maintains that twelve of its banks were closed illegally or improvidently. The closed institutions are not under the control of MCorp because they are under FDIC receiverships.

The Federal Reserve Board has initiated administrative actions against MCorp as a bank holding company for violating its regulations that ensure the integrity of the banking system through the requirement that the holding company be a "source of financial strength" to the subsidiary banks. The administrative actions will conflict with MCorp's ability to address a global reorganization in the bankruptcy case.

4. *Standard for Injunctive Relief.*

This proceeding is in the nature of a preliminary declaratory judgment rather than a normal preliminary injunction which maintains some status between principal litigants until the merits of their claims have been heard. This injunction will prospectively assign one authority or another to supervise a restructuring.

Despite the peculiar nature, this injunction meets the regular requirements. *Canal Auth. v. Callaway*, 489 F.2d 567, 572 (5th Cir.1974).

A. MCorp is likely to prevail on the merits of its legal priority claim. The automatic stay is applied rigorously, and only in exceptional cases is there a departure from protecting the debtor. Where the regulation is inextricably mixed with the restructuring process rather than some ancillary public health or safety question, MCorp ought to succeed with its claim of insulation from the Board by the automatic stay. Even if the regulatory exemption applies, the highly probable result is MCorp's success because of the availability of the anti-interference protection.

B. Enjoining the Board is necessary to prevent imminent and irreparable harm to the Debtor; responding to the Board's proceedings deprives MCorp of resources desperately needed to prepare for its reorganization. If MCorp is to survive, to the benefit of the creditors and the government, it must act quickly, for a lingering Chapter 11 case inevitably becomes a liquidation. Obliging MCorp to respond in multiple forums to multiple agencies, each with its own internal and external priorities, would dissolve the focus MCorp needs to see the route to survival.

C. The risk to MCorp in both probability and magnitude exceeds the possible danger to the Board's interests. The safeguards of the bankruptcy code ensure the protection of the generalized interest of the Board in healthy holding companies. The Board's exposure to liability independent of its regulatory concern is minimal, and it is not jeopardized by this injunction. Its interest can adequately be represented in the bankruptcy proceedings.

D. The issuance of this injunction does not harm the public interest defined either as the general public interest or as the discernible interests of unrepresented third-parties. To the contrary, the public is served by having all proceedings in one forum, especially a forum where the individuals in the affected public can participate.

5. *Issue.*

When a bank holding company seeks reorganization under the bankruptcy code, does the general bankruptcy process supersede the processes of the agencies that regulate banking?

6. *Regulatory Framework.*

A. *Comptroller of the Currency.*

General supervision of national banks, including their creation and closing, is confided to the comptroller of the currency. If, on his examination, the comptroller determines that a bank is insolvent, he places it in receivership. That receiver is the FDIC. 12 U.S.C. § 191.

B. *Federal Deposit Insurance Corporation.*

The FDIC has two roles in banking regulation. First, it acts as a limited insurer of deposits to attract depositors to the banking system and to prevent runs, with their destructive effects. Second, the FDIC acts as a receiver for the estate of a bank that has been closed by the comptroller. 12 U.S.C. § 1811.

C. *Federal Reserve Board.*

The Federal Reserve System is the central bank for the United States, and among its powers are responsibilities for the regulation of banks and bank holding companies. The Board's regulation takes many forms, like its clearinghouse function, furnishing liquidity, margin and capital requirements, open market purchases and sales, and currency issuance.

Under the FISA, if the Board finds that a bank holding company has engaged in an unsafe or un-

sound practice, the Board has the authority to notify the company of its charges, stating the violations and setting a hearing before the Board. 12 U.S.C. § 1818(b). If the charges are proved, the Board can order the company to stop the derelict practices and to take affirmative steps to prevent future violations.

Temporary orders to desist may also be issued by the Board before proceedings are completed. These orders may be issued without a hearing and are effective immediately.

Because the purpose of vesting the Board with these powers is to assure the soundness of banks that are owned by holding companies, transactions between the parent company and its nonbank subsidiaries may be regulated to prevent losses to the bank subsidiaries.

7. *Classes of Regulation by the Board.*

The Board has claimed four classes of authority over the Debtor and its components. First, the Board is empowered to regulate the banking process, through its clearinghouse function, for example.

Second, the most obvious class of power that the Board has over banks is through its central bank functions. These directly affect the parties here, through reserve and margin requirements for instance, but they are fashioned at a higher level than individual bank operation. These are not involved; the bank subsidiaries of MCorp will continue to abide by the Board's general regulation of banking transactions.

Third, the Board is charged generally with supervision of bank and bank holding company practices that may endanger the integrity of the banks and the system of banks. These vaguely defined powers cover items from the re-

quirement of minimum capital to the prohibition of self-dealing.

Fourth, the Board asserts the authority to direct the activities of the holding company's nonbank subsidiaries in their transactions unrelated to banks or banking including forcing a sale for capital infusion.

8. ***Priority of Regulation.***

Banks cannot file for bankruptcy; they must reorganize or liquidate under the banking laws. Bank holding companies, however, are not prohibited from recourse to bankruptcy, and while they are regulated by banking agencies, they cannot be reorganized or liquidated under the laws for banks. Congress has amended both the banking and the bankruptcy laws several times, never resolving this potential conflict.

The new bankruptcy code was adopted in 1978, long after bank holding companies had been regulated. The holding company act has been frequently amended itself. The dual nature of bank holding companies implicates the interests of the systems both of regulation and of reorganization. The statutes as enacted limit the bank regulators to primacy in dealing with banks.

When a bank holding company is a debtor in possession, the conflict between the court's restructuring of the corporation and the Board's regulating can be resolved by allowing the Board to participate in the court proceeding. Preclusion by the bankruptcy forum would not cover the Board's clearinghouse or monetary functions, but it would restrict the Board's supervision of MCorp's asset allocation, intra-group transactions, and third-party contracts. This would give the Debtor the reprieve needed to retrieve its vitality.

Allowing the Board's proceedings to continue in a separate forum poses several problems. Parallel proceedings are

both confusing and inefficient. The potential for a successful reorganization would be jeopardized. The bankruptcy code is designed to be a comprehensive plan to rehabilitate the debtor to the exclusion of actions impairing reorganization.

Without minimizing the importance of the Board's administrative power over bank holding companies, the need for the court's power over the entirety of the debtor's estate takes precedence. This preemption is supported by policy and law.

Financial Institutions Supervisory Act, 12 U.S.C. § 1818(i), says:

> [N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Similar jurisdictional limitations have been overridden through control of the debtor's estate having been entrusted to the authority of the bankruptcy court. This construction has been employed in cases affecting the Court of Claims and the Tax Court (both administrative rather than judicial); their jurisdictional grants are parallel to the Board's and distinct from the judicial power through the bankruptcy code. *See In re Casey Corp.*, 46 B.R. 473 (Bankr.S.D.Ind.1985); *Bostwick v. United States*, 521 F.2d 741 (8th Cir.1975).

The *in rem* proceedings in admiralty, which are particular liquidation actions, yield to the bankruptcy code's plan for general liquidation. This is true even though maritime jurisdiction is directly a judicial power of international significance. *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985). The grant of jurisdiction over the debtor's estate for the restricted purpose of facilitating

the reorganization of the debtor supersedes other jurisdictional limits. 28 U.S.C. § 1334(d).

9. ***Regulatory Exception to the Stay.***

Even if the principal power over the debtor's estate is in the bankruptcy court, agencies whose mandate includes matters of "police or regulatory power" are not barred by the filing of a petition from pursuing the debtor. 11 U.S.C. § 362(b)(4). Although very few imaginable acts of a governmental unit could not plausibly be claimed to be within that category, congress did not act to exempt all governmental actions from the automatic stay, for the phrase "police and regulatory power" is a peculiar way to say "all."

A. There are two tests usually articulated in deciding whether the stay applies to a governmental action. Although neither of these dichotomies is particularly applicable with precision, they both do recognize that there are automatically stayed governmental activities.

   (1) The first divides governmental actions into two categories: pecuniary interest of the state in the debtor's estate or public policy affecting safety and health.

   (2) The second divides governmental actions into two slightly different categories: those that adjudicate private rights and those that effectuate public policy. *See N.L.R.B. v. Edward Cooper Painting, Inc.*, 804 F.2d 934, 942 (6th Cir.1986).

B. A solution to the definitional problem can be reached on procedural grounds. The principal difference between the automatic stay and the anti-interference injunction is the burden on the participants. For ordinary acts against the debtor's property, the stay has minimal risk to those who are blocked or the public. Because the automatic stay of private acts against the debtor's estate covers the majority of the debtor's relations, it has enough relief to allow reorganization. For governmental acts (as well as third-parties) to be blocked, however, the debtor must identify and move against them specifically through an injunction. The effect of this reading would produce a clear and reasonable approach, but it would still be an alteration of the plain text of the statute.

C. One solution to the lack of precision in the clause that allows some escape by governments from the stay is to attempt to classify governmental actions between those that are of immediate, actual concern to the health of the general public and those that are assists to private parties, asset allocations, and property acquisitions for its own account, as they are at cross purposes with the federal reorganization powers.

The Board's interest in protecting the public from "unsafe" banking practices may be important, but it does not rise to the level of injury or immediacy of aircraft certification, adulterated foods, or transportation of diseased livestock. 12 CFR 225, Reg. Y. In a case involving the Environmental Protection Agency, a court of appeals has said that the scope of the exemption from the stay is not limited to matters of imminent physical peril; however, the case dealt with a landfill without several safeguards, including a prevention of polluted runoff, so the comment was an observation, not a holding. *Matter Commonwealth Oil Refining Co., Inc.*, 805 F.2d 1175 (5th Cir.1986) *cert. denied sub nom. Commonwealth Oil and Refining Co. v.*

E.P.A., 483 U.S. 1005, 107 S.Ct. 3228, 97 L.Ed.2d 734 (1987). Notably, the legislative history of the code reveals that bankruptcy courts had been enforcing the automatic stay against state pollution abatement efforts. *See* HR Rep. No. 95-595, 95th Cong., 1st Sess., 174-5 (Bankruptcy Reform Act of 1978), U.S. Code Cong. & Admin.News 1978, pp. 5787, 6134, 6135.

One court has held that access to assets that are necessary to the business's future vitality are exempt regulatory matters, and not even property of the debtor's estate since the assets were useful only through further regulation. *In re Braniff Airways,* 700 F.2d 935 (5th Cir.1983) (landing slots necessary for reorganization were not subject to bankruptcy court orders over FAA).

On the other hand, there are cases restricting the exemption from the stay to matters directly affecting the public safety, which should not be interrupted pending a hearing to lift the stay. Others have held that some parallel proceedings, like competing license applications, that might require some distraction to the debtor's reorganization effort are not stayed through the exemption even though they do not involve palpable health hazards. *See Jordan v. Randolph Mills, Inc.*, 716 F.2d 1053 (4th Cir.1983); *In re D.H. Overmyer Telecasting Co., Inc.*, 35 B.R. 400 (Bankr.N.D.Ohio 1983).

10. *Governmental Actions Not Excepted from the Stay.*

Ignoring the distinction between "all" and "police-regulatory" is easy and wrong; by the plain terms of the statute there are governmental actions that are not exempted from the stay. To determine whether a governmental function is among those that should be exempt, the court must evaluate the function of the regulation, the probability of direct public harm, the opportunity for the public interest to be effectively represented in the bankruptcy proceeding, and the relation between the regulation and the financial, legal, and structural requirements for an effective reorganization. *See In re King Memorial Hospital, Inc.*, 4 B.R. 704 (Bankr.S.D.Fla.1980); *In re Joe DeLisi Fruit Co.*, 11 B.R. 694 (Bankr.D.Minn.1981).

Both the Board's generalized, diffuse interest in the holding comany as well as the duplicative, distracting hearings militate for its being not exempt from the stay.

11. *Reorganization by Subterfuge.*

MCorp argues that the current state of regulatory orders issuing from the Board is effectively an attempt by the Board to control the estate of the Debtor for the purpose of dictating MCorp's future structure. While this appears plausible, it is unnecessary to address it in detail because the stay applies to most of the regulation and because the Board is subject to the anti-interference prohibition. 11 U.S.C. § 105.

The bankruptcy court can scrutinize the potential for undisclosed motivations when the Board presents a motion to lift the stay.

12. *Anti-Interference Authority.*

Whatever the role of the automatic stay, the bankruptcy code authorizes an injunction against third parties from conducting otherwise fully legitimate actions when those actions would impede the viability of the debtor's reorganization. The Board claims an exemption from the anti-interference power parallel to the regulatory exemption from the automatic stay. Virtually any company is subject to a variety of regulatory agencies, and no reorganization would be possible without requiring the federal, state, and local authorities to submit their claims through the bank-

ruptcy process. Securities issued as a consequence of a bankruptcy supervised reorganization are expressly exempt from the registration requirements of the Securities and Exchange Commission. 11 U.S.C. § 1145.

The court shares the Board's concern that the laudable but limited purposes of bankruptcy not be perverted into an escape from regulation. The bankruptcy process includes a vigilant, fully empowered judge who will prevent individual or collusive efforts to evade the Debtor's responsibilities to the public.

The Board's interest in MCorp, as distinct from the comptroller or FDIC's interest in the banks, is secondary and diffuse. The overlapping authority between bank regulators and bankruptcy courts is resolved in favor of the court. As an example, when responding to a receivership imposed by a district court under the Securities and Exchange Commission's authority, it has been said that "To the extent that the exercise of this jurisdiction threatens the assets of the debtor's estate, the bankruptcy court may issue a stay of those proceedings." *Securities & Exch. Comm'n v. First Fin. Group of Texas,* 645 F.2d 429, 440 (5th Cir.1981).

13. *Conclusion.*

While the operation of the banking system under the guidance of the Board is an important interest, congress has also recognized the importance of allowing debtors to restructure so that they may make a contribution to the economic vitality of the country. Under the circumstances of a bank holding company with nonbank subsidiaries, accommodation of the two national interests in bankruptcy and banking requires that the bankruptcy court have primacy over the non-operations aspects of the debtor and that the Board, after participating, abide by the capital

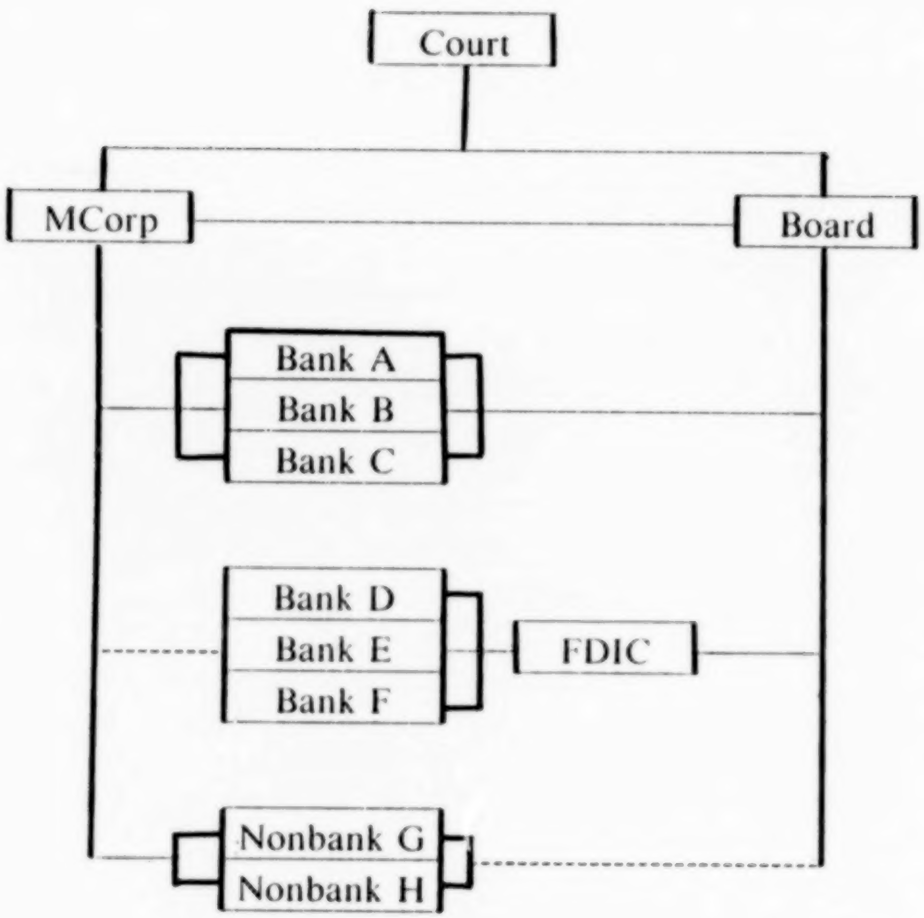
allocation and structural aspects of the debtor as determined in the bankruptcy rather than conducting its independent actions.

The court is mindful that a debtor that follows MCorp's precedent may attempt to abuse the opportunity furnished by the bankruptcy code, but the principle here is clear, and it must be applied with care, even here. The court is also mindful of who was paid to prevent the bank practices that resulted in the collapse of the system in the Southwest. Neither side has an occasion for self-righteousness.

The Board will be enjoined to allow the claims in its pending charges to abate, except through the bankruptcy court.

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Background of the Controversy" section of the opinion of June 9, 1989.

APPENDIX A.



A-C represent remaining subsidiary banks.
D-F represent subsidiary banks declared insolvent.
G-H represent nonbank subsidiaries.

PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM'S PROCEEDING ADMINISTRATIVELY AGAINST MCORP

1. *Parties.*

A. The parties plaintiff are:

(1) MCorp, a bank holding company;

(2) MCorp Financial, Inc., a non-bank subsidiary of MCorp; and

(3) MCorp Management, a non-bank subsidiary of MCorp.

(4) Each of the plaintiffs are debtors in possession (MCorp collectively).

B. The Official Creditors Committee formed under the bankruptcy statutes has been allowed to intervene.

C. The party defendant is the Board of Governors of the Federal Reserve System of the United States (Board).

2. *Related Proceedings.* This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp. and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp, and it was transferred here to pend under Case Number 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

D. The three bankruptcy actions have been consolidated under the earliest case number for joint administration.

3. *Reasons.* The court finds these to be reasons to grant injunctive relief:

A. The allocation of power to supervise bank holding companies conflicts when the corporation has sought protection under the bankruptcy statutes, and the conflicts can be minimized only through the intervention of the court.

B. The waste and confusion attendant upon parallel bankruptcy and administrative proceedings would defeat the legislative expectation of both sets of statutes, harm irreparably the estates of the bankrupts and their creditors (including the various governmental claims), escalate transaction costs by duplication and conflict, and protect no public interest or governmental function not fully addressable in the bankruptcy proceeding.

C. Prevalence on the merits in this case appears to be reduced to a correct interpretation of which public forum has precedence when a bank holding company has subsidiaries that include non-banks; however, MCorp is likely to prevail on its claim that the executive's administrative power over bank holding companies is preempted by the bankruptcy power which congress has confided to the judiciary.

D. Neither an interest of the public nor an interest of a group of nonparties will be harmed by this injunctive solution to the regulatory conflict.

4. *Restraint.* It is decreed that:

A. The Board is preliminarily enjoined from prosecuting:

(1) Notice of Charges dated October 19, 1988;

(2) Amended Notice of Charges dated October 26, 1988;

(2) Notice of Charges dated March 30, 1989, and;

(4) Second Amended Notice of Charges dated May 24, 1989, issued by the Board to MCorp, and

B. The Board is preliminarily enjoined from enforcing the temporary desist orders issued by the Board to MCorp. dated October 19, 1988, and October 26, 1988.

C. The Board may continue its general execution, supervisory, and examination duties of the operations of MCorp and its bank subsidiaries and may continue its central bank duties as they affect MCorp in common with all other institutions.

D. The Board is enjoined from using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganizaton of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

E. The restraint of this order is effective against the governors, the Federal Reserve System, its employees, its agents, and those acting in concert with them; however, the restraint does not apply to parallel agencies of the government like the Comptroller of the Currency or the Federal Deposit Insurance Corporation as they may independently pursue their regulatory mandates.

5. *Prospective Board Actions.*

A. The Board shall present proposed new administrative proceedings by it against MCorp or the pro-

posed issuance of new notices of charges or new temporary desist orders to MCorp.

B. If the parties cannot agree that the subject of the new proceeding is within the category of regulation exempted from this injunction, then the proposed action shall be presented to this court to determine whether it is an operational issue for the Board or an asset-structural issue for the bankruptcy court.

6. *Further Proceedings.*

A. Under emergency scheduling, the parties may seek modification of this order after notice to the parties.

B. The trial will not be set until the bankruptcy court has had a reasonable opportunity to address the issues raised by MCorp having subsidiaries banks and non-banks.

C. A status conference is set for:

August 15, 1989
10:00 a.m. Tuesday.

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Related Proceedings" section of the judgment rendered on June 2, 1989, and signed June 3, 1989.

APPENDIX D

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 3(a) of the Bank Holding Company Act of 1956, 12 U.S.C. 1842(a):

Prior approval of Board as necessary; exceptions; disposition, time extension; subsequent approval or disposition upon disapproval

It shall be unlawful, except with the prior approval of the Board, (1) for any action to be taken that causes any company to become a bank holding company; (2) for any action to be taken that causes a bank to become a subsidiary of a bank holding company; (3) for any bank holding company to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank; (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; or (5) for any bank holding company to merge or consolidate with any other bank holding company. Notwithstanding the foregoing this prohibition shall not apply to (A) shares acquired by a bank, (i) in good faith in a fiduciary capacity, except where such shares are held under a trust that constitutes a company as defined in section 1841(b) of this title and except as provided in paragraphs (2) and (3) of section 1841(g) of this title, or (ii) in the regular course of securing or collecting a debt previously contracted in good faith, but any shares acquired after May 9, 1956, in securing or collecting any such previously contracted debt shall be disposed of within a period of two years from the date on which they were acquired; or (B) additional shares acquired by a bank holding company in a bank in which such bank holding company owned or controlled a majority of the voting shares

prior to such acquisition. The Board is authorized upon application by a bank to extend, from time to time for not more than one year at a time, the two-year period referred to above for disposing of any shares acquired by a bank in the regular course of securing or collecting a debt previously contracted in good faith, if, in the Board's judgment, such an extension would not be detrimental to the public interest, but no such extension shall in the aggregate exceed three years. For the purpose of the preceding sentence, bank shares acquired after December 31, 1970, shall not be deemed to have been acquired in good faith in a fiduciary capacity if the acquiring bank or company has sole discretionary authority to exercise voting rights with respect thereto, but in such instances acquisitions may be made without prior approval of the Board if the Board, upon application filed within ninety days after the shares are acquired, approves retention or, if retention is disapproved, the acquiring bank disposes of the shares or its sole discretionary voting rights within two years after issuance of the order of disapproval.

Section 3(c) of the Bank Holding Company Act of 1956, 12 U.S.C. 1842(c):

Factors governing determination of application for approval

The Board shall not approve—

(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize of banking in any part of the United States, or

(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint [of] trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in

the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served. Notwithstanding any other provision of law, the Board shall not follow any practice or policy in the consideration of the application for the formation of a one-bank holding company if following such practice or policy would result in the rejection of such application solely because the transaction to form such one-bank holding company involves a bank stock loan which is for a period of not more than twenty-five years. The previous sentence shall not be construed to prohibit the Board from rejecting any application solely because the other financial arrangements are considered unsatisfactory. The Board shall consider transactions involving bank stock loans for the formation of a one-bank holding company having a maturity of twelve years or more on a case by case basis and no such transaction shall be approved if the Board believes the safety or soundness of the bank may be jeopardized.

Section 5 of the Bank Holding Company Act of 1956, 12 U.S.C. 1844:

Administration

(a) Registration of bank holding company

Within one hundred and eighty days after May 9, 1956, or within one hundred and eighty days after becoming a bank holding company, whichever is later, each bank holding company shall register with the Board on forms prescribed by the Board, which shall include such information with respect to the financial condition and operations, management, and intercompany relationships of the bank holding company and its subsidiaries, and related

matters, as the Board may deem necessary or appropriate to carry out the purposes of this chapter. The Board may, in its discretion, extend the time within which a bank holding company shall register and file the requisite information.

(b) Regulations and orders

The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.

(c) Reports required by Board; examinations; cost of examination

The Board from time to time may require reports under oath to keep it informed as to whether the provisions of this chapter and such regulations and orders issued thereunder have been complied with; and the Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which shall be assessed against, and paid by, such holding company. The Board shall, as far as possible, use the report of examinations made by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the appropriate State bank supervisory authority for the purposes of this section.

(d) Reports to the Congress; recommendations

Before the expiration of two years following May 9, 1956, and each year thereafter in the Board's annual report to the Congress, the Board shall report to the Congress the results of the administration of this chapter, stating what, if any, substantial difficulties have been encountered in carrying out the purposes of this chapter, and any recommendations as to changes in the law which in the opinion of the Board would be desirable.

(e) Termination of activities or ownership or control of nonbank subsidiaries constituting serious risk

(1) Notwithstanding any other provision of this chapter, the Board may, whenever it has reasonable cause to believe that the continuation by a bank holding company of any activity or of ownership or control of any of its nonbank subsidiaries other than a nonbank subsidiary of a bank, constitutes a serious risk to the financial safety, soundness, or stability of a bank holding company subsidiary bank and is inconsistent with sound banking principles or with the purposes of this chapter or with the Financial Institutions Supervisory Act of 1966, order the bank holding company or any such nonbank subsidiaries, after due notice and opportunity for hearing, and after considering the views of the bank's primary supervisor, which shall be the Comptroller of the Currency in the case of a national bank or the Federal Deposit Insurance Corporation and the appropriate State supervisory authority in the case of an insured nonmember bank, to terminate such activities or to terminate (within one hundred and twenty days or such longer period as the Board may direct in unusual circumstances) its ownership or control of any such subsidiary either by sale or by distribution of the shares of the subsidiary to the shareholders of the bank holding company. Such distribution shall be pro rata with respect to all of the shareholders of the distributing bank holding company, and the holding company shall not make any charge to its shareholders arising out of such a distribution.

(2) The Board may in its discretion apply to the United States district court within the jurisdiction of which the principal office of the holding company is located, for the enforcement of any effective and outstanding order issued under this section, and such court shall have jurisdiction

and power to order and require compliance therewith, but except as provided in section 1848 of this title, no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

(f) Powers of Board respecting applications, examinations, or other proceedings

In the course of or in connection with an application, examination, investigation or other proceeding under this chapter, the Board, or any member or designated representative thereof, including any person designated to conduct any hearing under this chapter, shall have the power to administer oaths and affirmations, to take or cause to be taken depositions, and to issue, revoke, quash, or modify subpenas and subpenas duces tecum; and the Board is empowered to make rules and regulations to effectuate the purposes of this subsection. The attendance of witnesses and the production of documents provided for in this subsection may be required from any place in any State or in any territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. Any party to proceedings under this chapter may apply to the United States District Court for the District of Columbia, or the United States district court for the judicial district or the United States court in any territory in which such proceeding is being conducted or where the witness resides or carries on business, for the enforcement or any subpena or subpena duces tecum issued pursuant to this subsection, and such courts shall have jurisdiction and power to order and require compliance therewith. Witnesses subpenaed under this subsection shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States.

Any service required under this subsection may be made by registered mail, or in such other manner reasonably calculated to give actual notice as the Board may by regulation or otherwise provide. Any court having jurisdiction of any proceeding instituted under this subsection may allow to any such party such reasonable expenses and attorneys' fees as it deems just and proper. Any person who willfully shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in such person's power so to do, in obedience to the subpena of the Board, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year or both.

The Financial Institutions Supervisory Act, 12 U.S.C. 1818, provides in pertinent part:

Termination of status as insured bank

(a) Notice by bank of intention; citation of bank for unsound practices or violations; hearings; judicial review

Any insured bank (except a national member bank, a foreign bank having an insured branch which is a Federal branch, a foreign bank having an insured branch which is required to be insured under section 3104(a) or (b) of this title, or State member bank) may, upon not less than ninety days' written notice to the Corporation, terminate its status as an insured bank. Whenever the Board of Directors shall find that an insured bank or its directors or trustees have engaged or are engaging in unsafe or unsound practices in conducting the business of such bank, or is in an unsafe or unsound condition to continue operations as an insured bank, or violated an applicable law, rule, regulation or order, or any condition imposed in writing by the Corporation in connection with the granting of any application

or other request by the bank, or any written agreement entered into with the Corporation the Board of Directors shall first give to the Comptroller of the Currency in the case of a national bank or a district bank, to the Federal Home Loan Bank Board in the case of an insured Federal savings bank, to the authority having supervision of the bank in the case of a State bank, and to the Board of Governors of the Federal Reserve System in the case of a State member bank, a statement with respect to such practices or violations for the purpose of securing the correction thereof and shall give a copy thereof to the bank. Unless such correction shall be made within one hundred and twenty days, or such shorter period not less than twenty days fixed by the Corporation in any case where the Board of Directors in its discretion has determined that the insurance risk of the Corporation is unduly jeopardized, or fixed by the Comptroller of the Currency in the case of a national bank, or the Federal Home Loan Bank Board in the case of an insured Federal savings bank, or the State authority in the case of a State bank, or Board of Governors of the Federal Reserve System in the case of a State member bank as the case may be, the Board of Directors, if it shall determine to proceed further, shall give to the bank not less than thirty days' written notice of intention to terminate the status of the bank as an insured bank, and shall fix a time and place for a hearing before the Board of Directors or before a person designated by it to conduct such hearing, at which evidence may be produced, and upon such evidence the Board of Directors shall make written findings which shall be conclusive. If the Board of Directors shall find that any unsafe or unsound practice or condition or violation specified in such statement has been established and has not been corrected within the time above prescribed in which to make such corrections, the Board of Directors may order that the insured status of the bank be terminated on a date subsequent to such finding

and to the expiration of the time specified in such notice of intention. Unless the bank shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the termination of its status as an insured bank and termination of such status thereupon may be ordered. Any insured bank whose insured status has been terminated by order of the Board of Directors under this subsection shall have the right of judicial review of such order only to the same extent as provided for the review of orders under subsection (h) of this section. The Corporation may publish notice of such termination and the bank shall give notice of such termination to each of its depositors at his last address of record on the books of the bank, in such manner and at such time as the Board of Directors may find to be necessary and may order for the protection of depositors. After the termination of the insured status of any bank under the provisions of this subsection, the insured deposits of each depositor in the bank on the date of such termination, less all subsequent withdrawals from any deposits of two years to be insured, and the bank shall continue to pay to the Corporation assessments as in the case of an insured bank during such period. No additions to any such deposits and no new deposits in such bank made after the date of such termination shall be insured by the Corporation, and the bank shall not advertise or hold itself out as having insured deposits unless in the same connection it shall also state with equal prominence that such additions to deposits and new deposits made after such date are not so insured. Such bank shall, in all other respects, be subject to the duties and obligations of an insured bank for the period of two years from the date of such termination, and in the event that such bank shall be closed on account of inability to meet the demands of its depositors within such period of two years, the Corporation shall have the same powers and rights with respect to such bank as in case of an insured bank.

(b) Cease-and-desist proceedings

(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to engage, in an unsafe or unsound practice in conducting the business of such bank, or is violating or has violated, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency in connection with the granting of any application or other request by the bank or any written agreement entered into with the agency, the agency may issue and serve upon the bank or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the agency at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of

the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

(2) A cease-and-desist order shall become effective at the expiration of thirty days after the service of such order upon the bank or other person concerned (except in the case of a cease-and-desist order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein, except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

(3) This subsection and subsections (c) through (f) and (h) through (n) of this section shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956 [12 U.S.C. 1841 et seq.], and to any organization organized and operated under section 25(a) of the Federal Reserve Act [12 U.S.C. 611 et seq.] or operating under section 25 of the Federal Reserve Act [12 U.S.C. 601 et seq.], in the same manner as they apply to a State member insured bank. Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency,

other than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank)

(4) This subsection and subsections (c), (d), (h), (i), (k), (l), (m), and (n) of this section shall apply to any foreign bank or company to which subsection (a) of section 3106 of this title applies and to any subsidiary (other than a bank) of any such foreign bank or company in the same manner as they apply to a bank holding company and any subsidiary thereof (other than a bank) under subparagraph (3) of this subsection. For the purposes of this paragraph, the term "subsidiary" shall have the meaning assigned to it in section 2 of the Bank Holding Company Act of 1956 [12 U.S.C. 1841].

(5) This section shall apply, in the same manner as it applies to any insured bank for which the appropriate Federal banking agency is the Comptroller of the Currency, to any national banking association chartered by the Comptroller of the Currency, including an uninsured association.

(c) Temporary cease-and-desist orders

(1) Whenever the appropriate Federal banking agency shall determine that the violation or threatened violation or the unsafe or unsound practice or practices, specified in the notice of charges served upon the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank pursuant to paragraph (1) of subsection (b) of this section, or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors prior to the completion of the proceedings conducted pursuant to paragraph (1) of subsection (b) of this section, the agency

may issue a temporary order requiring the bank or such director, officer, employee, agent, or other person to cease and desist from any such violation or practice and to take affirmative action to prevent such insolvency, dissipation, condition, or prejudice pending completion of such proceedings. Such order shall become effective upon service upon the bank or such director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank and, unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (2) of this subsection, shall remain effective and enforceable pending the completion of the administrative proceedings pursuant to such notice and until such time as the agency shall dismiss the charges specified in such notice, or if a cease-and-desist order is issued against the bank or such director, officer, employee, agent, or other person, until the effective date of such order.

(2) Within ten days after the bank concerned or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank has been served with a temporary cease-and-desist order, the bank or such director, officer, employee, agent, or other person may apply to the United States district court for the judicial district in which the home office of the bank is located, or the United States District Court for the District of Columbia, for an injunction * * * setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings pursuant to the notice of charges served upon the bank or such director, officer, employee, agent, or other person under paragraph (1) of subsection (b) of this section, and such court shall have jurisdiction to issue such injunction.

(d) Temporary cease-and-desist orders; enforcement

In the case of violation or threatened violation of, or failure to obey, a temporary cease-and-desist order issued pursuant to paragraph (1) of subsection (c) of this section, the appropriate Federal banking agency may apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for an injunction to enforce such order, and, if the court shall determine that there has been such violation or threatened violation or failure to obey, it shall be the duty of the court to issue such injunction.

* * * * *

(h) Hearings and judicial review

(1) Any hearing provided for in this section (other than the hearing provided for in subsection (g)(3) of this section) shall be held in the Federal judicial district or in the territory in which the home office of the bank is located unless the party afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5. Such hearing shall be private, unless the appropriate Federal banking agency, in its discretion, after fully considering the views of the party afforded the hearing, determines that a public hearing is necessary to protect the public interest. After such hearing, and within ninety days after the appropriate Federal banking agency or Board of Governors of the Federal Reserve System has notified the parties that the case has been submitted to it for final decision, it shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and serve upon each party to the proceeding an order or orders consistent with the provisions of this section. Judicial review of any such order shall be exclusively as provided in this subsection (h). Unless a petition for review is timely filed in a court of appeals of the United States, as hereinafter provided in

paragraph (2) of this subsection, and thereafter until the record in the proceeding has been filed as so provided, the issuing agency may at any time, upon such notice and in such manner as it shall deem proper, modify, terminate, or set aside any such order. Upon such filing of the record, the agency may modify, terminate, or set aside any such order with permission of the court.

(2) Any party to the proceeding, or any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order served pursuant to paragraph (1) of this subsection (other than an order issued with the consent of the bank or the director or officer or other person concerned, or an order issued under paragraph (1) of subsection (g) of this section) by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the agency be modified, terminated, or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the agency, and thereupon the agency shall file in the court the record in the proceeding, as provided in section 2112 of title 28. Upon the filing of such petition, such court shall have jurisdiction, which upon the filing of the record shall except as provided in the last sentence of said paragraph (1) be exclusive to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency. Review of such proceedings shall be had as provided in chapter 7 of title 5. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 1254 of title 28.

(3) The commencement of proceedings for judicial review under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of any order issued by the agency.

(i) Jurisdiction and enforcement; penalty

(1) The appropriate Federal banking agency may in its discretion apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

(2)(i) Any insured bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such bank who violates the terms of any order which has become final and was issued pursuant to subsection (b), (c), or (s) of this section, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: *Provided,* That the agency having authority to impose a civil money penalty may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the appropriate Federal banking agency by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting, a violation.

(ii) In determining the amount of the penalty the appropriate Federal banking agency shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the insured bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may required.

(iii) The insured bank or person assessed shall be afforded an opportunity for agency hearing, upon request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of title 5. The agency determination shall be made by final order which may be reviewed only as provided in subparagraph (iv). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

(iv) Any insured bank or person against whom an order imposing a civil money penalty has been entered after agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the insured bank is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within twenty days from the service of such order, and simultaneously sending a copy of such notice by registered or certified mail to the appropriate Federal banking agency. The agency shall promptly certify and file in such Court the record upon which the penalty was imposed, as provided in section 2112 of title 28. The findings of the agency shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of title 5.

(v) If any insured bank or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the agency shall refer the matter to

the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

(vi) Each Federal banking agency shall promulgate regulations establishing procedures necessary to implement this paragraph.

(vii) All penalties collected under authority of this section shall be covered into the Treasury of the United States.

* * * * *

(k) Definitions

As used in this section (1) the terms "cease-and-desist order which has become final" and "order which has become final" mean a cease-and-desist order, or an order, issued by the appropriate Federal banking agency with the consent of the bank or the director or officer or other person concerned, or with respect to which no petition for review of the action of the agency has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (h) of this section, or with respect to which the action of the court in which said petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in said paragraph, or an order issued under paragraph (1) or (3) of subsection (g) of this section, and (2) the term "violation" includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, tit. IX, 103 Stat. 450-451 (amending 12 U.S.C. 1818(b) and (c)), provides in pertinent part:

Amendments To Cease And Desist Authority With Respect To Restitution, Restrictions On Specific Activities, Grounds For Issuance Of a Temporary Order, And Incomplete Or Inaccurate Records

(a) Depository Institutions Insured by the FDIC. –

(1) Cease and Desist Authority. – Section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)) is amended –

(A) in paragraph (3), by striking out "subsections (c) through (f) and (h) through (n)," and inserting in lieu thereof "subsections (c) through (s) and subsection (u)";

(B) in paragraph (4), by striking out "subsections (c) through (f) and (h) through (n)" and inserting in lieu thereof "subsections (c) through (s) and subsection (u)"; and

(C) by adding at the end thereof the following new paragraphs:

"(6) Affirmative action to correct conditions resulting from violations or practices. – This authority to issue an order under this subsection and subsection (c) which requires an insured depository institution or any institution-affiliated party to take affirmative action to correct any conditions resulting from any violation or practice with respect to which such order is issued includes the authority to require such depository institution or such party to –

"(A) make restitution or provide reimbursement, indemnification, or guarantee against loss if –

"(i) such depository institution or such party was unjustly enriched in connection with such violation or practice; or

"(ii) the violation or practice involved a reckless disregard for the law or any applicable regulations or prior order of the appropriate Federal banking agency;

"(B) restrict the growth of the institution;

"(C) dispose of any loan or asset involved;

"(D) rescind agreements or contracts; and

"(E) employ qualified officers or employees (who may be subject to approval by the appropriate Federal banking agency at the direction of such agency); and

"(F) take such other action as the banking agency determines to be appropriate.

"(7) Authority to limit activities. – The authority to issue an order under this subsection or subsection (c) includes the authority to place limitations on the activities or functions of an insured depository institution or any institution-affiliated party.

"(8) Expansion of authority to savings and loan affiliates and entities. – Subsections (a) through (s) and subsection (u) shall apply to any savings and loan holding company and to any subsidiary (other than a bank or subsidiary of that bank) of a savings and loan holding company, to any service corporation of a savings association and to any subsidiary of such service corporation, whether wholly or partly owned, in the same manner as such subsections apply to a savings association.".

(2) Temporary cease and desist authority. – Section 8(c) of the Federal Deposit Insurance Act (12 U.S.C. 1818(c)) is amended –

(A) in paragraph (1) –

(i) by striking out "substantial" and inserting in lieu thereof "significant";

(ii) by strking out "seriously" each place such term appears; and

(iii) by inserting after the 1st sentence the following new sentence; "Such order may include any requirement authorized under subsection (b)(6)(B)."; and

(B) by adding at the end thereof the following new paragraph:

"(3) Incomplete or inaccurate records. –

"(A) Temporary order. – If a notice of charges served under subsection (b)(1) specifies, on the basis of particular facts and circumstances, that an insured depository institution's books and records are so incomplete or inaccurate that the appropriate Federal banking agency is unable, through the normal supervisory process, to determine the financial condition of that depository institution or the details or purpose of any transaction or transactions that may have a material effect on the financial condition of that depository institution, the agency may issue a temporary order requiring –

"(i) the cessation of any activity or practice which gave rise, whether in whole or in part, to the incomplete or inaccurate state of the books or records; or

"(ii) affirmative action to restore such books or records to a complete and accurate state, until the completion of the proceedings under subsection (b)(1).

"(B) Effective period. – Any temporary order issued under subparagraph (A) –

"(i) shall become effective upon service; and

"(ii) unless set aside, limited, or suspended by a court in proceedings under paragraph (2), shall remain in effect and enforceable until the earlier of –

"(I) the completion of the proceeding initiated under subsection (b)(1) in connection with the notice of charges; or

"(II) the date the appropriate Federal banking agency determines, by examination or otherwise, that the insured depository institution's books and records are accurate and reflect the financial condition of the depository institution."

Section 908 of the International Lending Supervision Act of 1983, 12 U.S.C. 3907:

Capital adequacy

(a)(1) Each appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by using such other methods as the appropriate Federal banking agency deems appropriate.

(2) Each appropriate Federal banking agency shall have the authority to establish such minimum level of capital for a banking institution as the appropriate Federal banking agency, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the banking institution.

(b)(1) Failure of a banking institution to maintain capital at or above its minimum level as established pursuant to subsection (a) of this section may be deemed by the appropriate Federal banking agency, in its discretion, to constitute an unsafe and unsound practice within the meaning of section 1818 of this title.

(2)(A) In addition to, or in lieu of, any other action authorized by law, including paragraph (1), the appropriate Federal banking agency may issue a directive to a banking institution that fails to maintain capital at or above its required level as established pursuant to subsection (a) of this section.

(B)(i) Such directive may require the banking institution to submit and adhere to a plan acceptable to the appropriate Federal banking agency describing the means and timing by which the banking institution shall achieve its required capital level.

(ii) Any such directive issued pursuant to this paragraph, including plans submitted pursuant thereto, shall be enforceable under the provisions of section 1818(i) of this title to the same extent as an effective and outstanding order issued pursuant to section 1818(b) of this title which has become final.

(3)(A) Each appropriate Federal banking agency may consider such banking institution's progress in adhering to any plan required under this subsection whenever such banking institution, or an affiliate thereof, or the holding company which controls such banking institution, seeks the requisite approval of such appropriate Federal banking agency for any proposal which would divert earnings, diminish capital, or otherwise impede such banking institution's progress in achieving its minimum capital level.

(B) Such appropriate Federal banking agency may deny such approval where it determines that such proposal would adversely affect the ability of the banking institution to comply with such plan.

(C) The Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury shall encourage governments, central banks, and regulatory authorities of other major banking countries to work

toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending.

Section 910 of the International Lending Supervision Act of 1983, 12 U.S.C. 3909:

General Authorities

(a) Rules and regulations

(1) The appropriate Federal banking agencies are authorized to interpret and define the terms used in this chapter, and each appropriate Federal banking agency shall prescribe rules or regulations or issue orders as necessary to effectuate the purposes of this chapter and prevent evasions thereof.

(2) The appropriate Federal banking agency is authorized to apply the provisions of this chapter to any affiliate of an insured bank, but only to affiliates for which it is the appropriate Federal banking agency, in order to promote uniform application of this chapter or to prevent evasions thereof.

(3) For purposes of this section, the term "affiliate" shall have the same meaning as in section 371c of this title, except that the term "member bank" in such section shall be deemed to refer to an "insured bank", as such term is used in section 1813(h) of this title.

* * * * *

(c) Existing authorities

(1) The powers and authorities granted in this chapter shall be supplemental to and shall not be deemed in any manner to derogate from or restrict the authority of each appropriate Federal banking agency under section 1818 of this title or any other law including the authority to require additional capital or reserves.

(2) Any such authority may be used by any appropriate Federal banking agency to ensure compliance by a banking institution with the provisions of this chapter and all rules, regulations, or orders issued pursuant thereto.

* * * * *

Title 12, Code of Federal Regulations, Part 225, provides in pertinent part:

Subpart A – General Provisions

§ 225.1 Authority, purpose, and scope.

(a) *Authority.* This part (Regulation Y) is issued by the Board of Governors of the Federal Reserve System ("Board") under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) ("BHC Act"); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13) ("Bank Control Act"); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818(b)); and the International Lending Supervision Act of 1983 (Pub. L. 98-181, Title IX). The BHC codified at 12 U.S.C. 1841, *et seq.*

(b) *Purpose.* The principal purposes of this part are to regulate the acquisition of control of banks by companies and individuals, to define and regulate the nonbanking activities in which bank holding companies and foreign banking organizations with United States operations may engage, and to set forth the procedures for securing approval for such transactions and activities.

(c) *Scope.* (1) Subpart A contains general provisions and definitions of terms used in this regulation.

* * * * *

§ 225.4 Corporate practices.

(a) *Bank holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not con[d]uct its operations in an unsafe or unsound manner.

(2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Supervisory Act of 1966 as amended (12 U.S.C. 1818(b) *et seq.*) the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

* * * * *

§ 225.5 Registration, reports, and inspections.

(a) *Registration of bank holding companies.* Each company shall register within 180 days after becoming a bank holding company by furnishing information in the manner and form prescribed by the Board. A company that receives the Board's prior approval under Subpart B of this regulation to become a bank holding company may complete this registration requirement through submission of its first annual report to the Board as required by paragraph (b) of this section.

(b) *Reports of bank holding companies.* Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year

during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.

(c) *Examinations and inspections.* The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operattions and activities. The Board will rely as far as possible on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of a bank holding company or of the branch or agency of the foreign bank.

§ 225.6 Penalties for violations.

(a) *Criminal and civil penalties.* Section 8 of the BHC Act provides criminal penalties for willful violation, and civil penalties for violation, by any company or individual of the BHC Act or any regulation or order issued under it, or for making a false entry in any book, report, or statement of a bank holding company. Civil money penalty assessments for violations of the BHC Act shall be made in accordance with Subpart B of the Board's Rules of Practice for Hearings (12 CFR Part 263, Subpart B). For any willful violation of the Bank Control Act or any regulation or order issued under it, the Board may assess a civil penalty as provided in 12 U.S.C. 1817(j)(15).

(b) *Cease and desist proceedings.* For any violation of the BHC Act, the Bank Control Act, this regulation, or any order or notice issued thereunder, the Board may institute a cease and desist proceeding in accordance with the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*).

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,
v.

MCORP, MCORP FINANCIAL INC. AND
MCORP MANAGEMENT,

and

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC. AND MCORP MANAGEMENT,
Respondents.

**On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Fifth Circuit**

**JOINT BRIEF OF MCORP, *et al.*,
IN OPPOSITION TO
PETITION OF BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM**

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February 11, 1991

QUESTIONS PRESENTED

1. Whether the court of appeals correctly ruled that the Board of Governors of the Federal Reserve System lacked statutory authority to compel a bank holding company to transfer all its available assets into its subsidiary banks.

2. Whether the Board of Governors' source-of-strength assessment Policy Statement is unenforceable because it was adopted in violation of the notice and comment requirements of the Administrative Procedure Act.

3. Whether the court of appeals properly remanded this case to the district court with instructions to enjoin the Board of Governors of the Federal Reserve system from further prosecution of its source-of-strength charges.

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JOINT BRIEF OF MCORP, *et al.*, IN OPPOSITION TO PETITION OF BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATUTORY PROVISIONS INVOLVED

Pertinent sections of the Bank Holding Company Act of 1956 ("BHC Act") (12 U.S.C. § 1841 *et seq.*), the International Lending Supervision Act of 1983 ("ILSA") (12 U.S.C. §§ 3907, 3909) and the Financial Institutions Supervisory Act of 1966 ("FISA") (12 U.S.C. § 1818), as amended by Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), are set forth in Appendix D to the Board's Petition. Pertinent sections of amendments to the National Bank Act adopted in 1933, 1935, 1953 and

1959, and of the Administrative Procedure Act, 5 U.S.C. § 553 ("APA"), are reprinted in an appendix hereto.

STATEMENT OF CASE

On June 9, 1989, the United States District Court for the Southern District of Texas, sitting in bankruptcy, ruled that the Board of Governors of the Federal Reserve System (the "Board") was not exempt from the automatic stay provisions of the Bankruptcy Code, 11 U.S.C. § 362, and granted in full MCorp's motion for a preliminary injunction enjoining the Board from prosecuting two separate administrative enforcement proceedings against MCorp[1] involving: (1) an alleged violation by MCorp of section 23A of the Federal Reserve Act (12 U.S.C. § 371c), and (2) an attempt to compel MCorp, pursuant to the Board's purported source-of-strength assessment authority, to transfer all its available assets to its subsidiary national banks, 20 of which were closed and placed in receivership on March 28, 1989.[2]

On May 15, 1990, the United States Court of Appeals for the Fifth Circuit vacated the injunction with respect to proceedings on the Board's Section 23A charges, ruling that the Bankruptcy Code did not supersede the Board's jurisdiction to prosecute its Section 23A charges against MCorp.[3] In addition, the court of appeals re-

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[1] MCorp is the parent company of both MCorp Financial, Inc. and MCorp Management. MCorp, MCorp Financial, Inc. and MCorp Management have no subsidiaries other than wholly owned subsidiaries of such corporations.

[2] In two related cases, the United States District Court for the Northern District of Texas has ruled that the Federal Deposit Insurance Corporation ("FDIC") and Comptroller of the Currency violated the National Bank Act in closing 12 of these banks that were solvent when seized. *MBank New Braunfels* v. *FDIC*, 721 F. Supp. 120 (N.D. Tex. 1989); *MCorp* v. *Clarke*, No. CA3-89-0831F, (N.D. Tex. Feb. 1, 1991) (copy lodged with Clerk of this Court).

[3] MCorp has filed a petition for a writ of certiorari seeking review of this aspect of the court of appeals decision. *MCorp Financial, Inc.* v. *Board of Governors, petition for cert. filed,* No. 90-914. The Court can resolve the distinct and separate substantial

manded to the district court with instructions to enjoin proceedings on the Board's source-of-strength charges because those "proceedings exceed[ed] its statutory authority." Board Pet. App. at 26a. On August 6, 1990, the court of appeals denied the Board's petition for rehearing and suggestion for rehearing *en banc,* and MCorp's suggestion for rehearing *en banc.*

On December 6 and December 20, 1990, after obtaining approvals from the bankruptcy court and the banking regulators, MCorp sold two of its five surviving subsidiary banks. MCorp has signed contracts for the sale of two more of its surviving banks. MCorp presently is negotiating with a potential purchaser of the remaining bank.

REASONS FOR DENYING THE WRIT

INTRODUCTION

The court of appeals correctly ruled that the source-of-strength assessment policy—pursuant to which the Board claims authority to compel a bank holding company to contribute all its available funds to a subsidiary bank—clearly exceeds the Board's statutory authority. The Board purports to find this authority from a "construction of interrelated statutory schemes" (Board Pet. at 14), although, as the Board concedes, no statute expressly grants this authority. The Board neglects to note, however, that on many occasions over the past 58 years, Congress has considered the very authority the Board asserts in its petition and in each instance refused to grant the Board the authority to compel bank holding companies to pour all their available funds into subsidiary banks. Indeed in the Banking Acts of 1933 and 1935, which established the initial framework for the regulation of bank holding companies, Congress expressly pro-

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issues presented in that certiorari petition relating to the interplay between the Bankruptcy Code and the scheme of federal bank regulation without addressing the different issues the Board raises here.

hibited banking regulators from imposing mandatory assessments on shareholders of national banks. More recently, the issue of shareholder assessment powers was again before Congress in 1987, 1988, 1989 and 1990, and is now pending before the current session of Congress in two bills introduced last month. To date, however, Congress has rejected these legislative efforts to invest the Board with shareholder assessment powers.

Moreover, contrary to the Board's unsupported assertions, the source-of-strength assessment policy is not "critically important" to the protection of the banking system and the federal deposit insurance funds, and its invalidity does not create a "regulatory vacuum." Since 1987, when the Board first proclaimed its source-of-strength assessment authority, both the economic wisdom and the legality of this purported authority have been challenged by the FDIC which, as the government agency responsible for administering the deposit insurance funds, would bear any "additional liability" to which those funds are exposed. *See* pp. 9, 12, *infra*. The FDIC instead sought and obtained for itself the statutory power to assess federally insured banks, but not bank holding companies or their nonbank subsidiaries, for the FDIC's losses in closing affiliated banks.

The Board's policy arguments for a source-of-strength assessment power—as well as any contrary arguments from the FDIC and other authorities—should properly be addressed, as they have been in the past, to Congress. They do not raise judicial issues warranting review by this Court.

Furthermore, the Board's 1987 source-of-strength Policy Statement purports to impose a substantive obligation and thus constitutes a "substantive rule", which could be adopted only in accordance with the notice and comment requirements of section 553 of the APA. Therefore, in addition to the absence of statutory authority, the Board's failure to comply with APA requirements for promulgating a substantive rule also renders the Policy Statement void and unenforceable.

Finally, the Board's jurisdictional arguments do not apply to *ultra vires* agency proceedings, and as a practical matter would not preclude MCorp from obtaining an early judicial ruling on the validity of source-of-strength assessments.

I. THE BOARD'S PROPOSED SOURCE-OF-STRENGTH ASSESSMENT AUTHORITY IS WHOLLY WITHOUT STATUTORY SUPPORT

A. Shareholder Assessments Were Banned by Congress

The Board concedes that it has no express statutory authority to assess bank holding companies for the losses of subsidiary banks, Board Pet. at 22-23, but argues that three statutes, when read together and considered as a whole, somehow impliedly grant it such authority.[4] According to the Board, nothing in these statutes "precludes the Board from determining—as a matter of sound federal banking policy—that bank holding companies, despite their legal status as separate corporate entities, must ultimately remain accountable for the capital adequacy of their subsidiary banks." Board Pet. at 25.

This unprecedented statutory analysis turns the law upside down. Agency authority must be rooted in an affirmative statutory grant. There can be no plenary grant of authority to administrative agencies to invest themselves with any power not expressly precluded by statute.

More importantly, the Board's theory incorrectly assumes Congressional silence on the issue of shareholder assessment authority. To the contrary, Congress has spoken directly to this issue on a number of occasions. As noted by the FDIC, the Board's claimed authority to assess bank holding companies for losses of capital of subsidiary banks is inconsistent with the repeal by Con-

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[4] The BHC Act, 12 U.S.C. § 1842(c), FISA, 12 U.S.C. § 1818, and ILSA, 12 U.S.C. § 3901 *et seq.* Board Pet. at 23-29.

gress of the various shareholder assessments previously authorized under the National Bank Act.[5]

As originally enacted in 1864, the National Bank Act imposed double liability on shareholders of national banks.[6] In a series of four amendments to the National Bank Act adopted in 1933, 1935, 1953 and 1959, Congress repealed these shareholder assessment provisions and completely eliminated the assessability of national bank stock.[7] These amendments embody the "manifest purpose and intention on the part of Congress to do away with the so-called 'stockholders' double liability' *and to ultimately abandon the same as a policy in the regulation of the banking business.*" [8]

In adopting these amendments Congress was quite aware that bank holding companies owned national

[5] *See* FDIC, *Mandate for Change: Restructuring the Banking Industry* 94 (Oct. 1987). All of MCorp's current and former subsidiary banks involved in the Board's action are (or were prior to their seizure) national banks.

[6] Act of June 3, 1864, ch. 106, 13 Stat. 99, formerly codified at 12 U.S.C. § 63. National bank shareholders were individually responsible for all "contracts, debts, and engagements" of the national bank "to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares."

[7] Banking Act of 1933, Pub. L. No. 73-66, § 22, 48 Stat. 162 (1933); Banking Act of 1935, Pub. L. No. 74-305, § 304, 49 Stat. 684 (1935); Act of May 18, 1953, Pub. L. No. 83-28, 67 Stat. 27 (1953); Act of Sept. 8, 1959, Pub. L. No .86-230, § 7, 73 Stat. 457 (1959). Over the same period, most of the states similarly repealed shareholder assessment provisions applicable to state-chartered banks. *Anderson* v. *Abbott*, 321 U.S. 349, 381 n.8 (1944) (Jackson, J. dissenting). Similarly, the FDI Act was amended to require the FDIC, acting as receiver, to waive stockholder assessments that might exist under state law. 12 U.S.C. § 1821(g)(3).

[8] *FDIC* v. *Henrich*, 26 F. Supp. 293, 294 (D.S.D. 1939), *aff'd*, 106 F.2d 633 (8th Cir. 1939) (emphasis added); *accord* H.R. Rep. No. 259, 83rd Cong., 1st Sess. (1953) ("It is the opinion of [the Housing banking] committee that the double liability feature on national bank stock should be once and for all eliminated.")

banks, and yet chose not to retain or impose any statutory provisions permitting assessment of national bank shares held by holding companies.[9] The last of the four amendments prohibiting assessment of national bank stock was enacted three years after the BHC Act.[10] Notably, section 19 of the Banking Act of 1933, which contained the initial provisions for Board regulation of bank holding companies, required a holding company to establish a special fund of liquid assets to satisfy assessments on national bank stock issued prior to 1933, which remained subject to assessment, and on the stock of those state-chartered banks for which assessability had not yet been repealed.[11] Ultimately, this liquid asset fund requirement was repealed as obsolete by the Bank Holding Company Act Amendments of 1966.[12]

Congress was keenly aware that, by eliminating the assessability of national bank stock, it was permitting shareholders to choose not to support a troubled bank.[13]

[9] *See* Banking Act of 1933, § 19 (the first federal statutory provisions governing bank holding companies), § 22 (providing that shares issued after adoption of Act were not assessable); Banking Act of 1935, § 311 (regulating bank holding company voting the stock of its subsidiary banks), § 304 (providing that shares of national bank not assessable after publication of notice); *Anderson* v. *Abbott*, 321 U.S. at 375-80 (Jackson, J., in dissent to a decision involving a pre-1933 assessment of national bank shares that was passed through as an assessment on shareholders of the bank's holding company, noted that Banking Act of 1933 both repealed assessability of national bank stock and provided for regulation of bank holding companies, but did not retain or create special assessment provisions applicable to bank holding companies).

[10] Pub. L. No. 86-230, § 7, 73 Stat. 457 (1959).

[11] Banking Act of 1933 § 19(b), (c), Pub. L. No. 73-66, formerly codified at 12 U.S.C. § 61.

[12] Bank Holding Company Act Amendments of 1966 § 13(c), Pub. L. 485, 89th Cong., 2d Sess., 80 Stat. 242 (1966); *Bank Holding Company Act Amendments of 1966*, S. Rep. No. 1179, 89th Cong., 2d Sess. at 12 (1966).

[13] As Controller O'Connor testified in 1935:

> Now, let me make that very particular: Here is a bank that has an impairment of its capital, and the Comptroller says,

Congress also was aware of the safety and soundness issue raised by eliminating stock assessability.[14] Congress, however, chose to address the safety and soundness issue by other means such as increasing the amount of capital required to be retained by banks, rather than by continuing to permit monetary assessments of the owners of national banks.[15]

These amendments to the National Bank Act, adopted during and out of the experience of the collapse of the banking system during the Great Depression, were motivated in large part by the determination of Congress that the *total elimination* of monetary assessments against national bank shareholders was necessary to attract new capital to rebuild the banking system.[16] Similar considerations weigh against the Board's latter-day attempt to revive for bank holding companies,

> "You have got to repair that capital and put up $100,000, or $1,000,000", and if there is no double liability, those directors and shareholders are not as interested in repairing that capital and working out the problems of that bank as if there was no double liability, because they are just apt to say, "Take it; its yours", and walk out of the picture.

Banking Act of 1935: Hearings Before House Comm. on Banking and Currency on H.R. 5357, 74th Cong., 1st Sess. 153 (testimony of Comptroller of the Currency O'Connor) ("1935 Hearings").

[14] As Comptroller of the Currency O'Connor testified:

> We must at once appreciate the fact that, by eliminating double liability on all national banks, we have tremendously weakened the banking structure of the nation. That must be clearly kept in mind. Therefore, I have suggested that, if the Congress decides to eliminate the double liability on all old national banks, the banks should be required to build up, out of their profits, some substantial amounts which shall go into a surplus fund of the banks.

1935 Hearings at 147 (testimony of Comptroller of Currency O'Connor).

[15] Banking Act of 1935, §§ 309, 315 (codified at 12 U.S.C. §§ 51, 60 (increasing surplus capital required to be retained by national banks)).

[16] 1935 Hearings at 153 (testimony of Comptroller O'Connor).

through its source-of-strength Policy Statement, the scheme of shareholder assessment statutes repealed long ago.[17] In the view of the FDIC:

> the "source-of-strength" doctrine does raise several questions. If this type of authority were asserted and proved to be enforceable, it would make investment in bank equities relatively unattractive: if the downside potential of an investment exceeds the initial commitment, investors will demand a higher expected return to compensate for the additional risk. It should be remembered that many bank stocks prior to the mid-1930s were subject to additional assessments if the bank experienced financial difficulties. This requirement was removed because of its negative effect on the ability of banks to raise new capital.[18]

Through the 1987 Policy Statement, the Board proposes, without benefit of statutory authority, to empower itself with unlimited authority to levy monetary assessments on corporate shareholders of banks, in direct contravention of the congressional repeal of shareholder assessment liability.

B. Congress Has Considered and Rejected Proposals to Reinstate Shareholder Assessment Authority

Congress has on numerous recent occasions considered various reformulations of the repealed bank shareholder assessment provisions. In 1987, Congress failed to act on legislation suggested by a House Committee Report that would have "implement[ed]" the Board's source-of-strength policy by creating a new liability rule that would have made "the holding company, in effect, commit all its resources to back the deposits of each bank or thrift

[17] See FDIC, *Mandate for Change: Restructuring the Banking Industry* 93-94 (Oct. 1987); FDIC, *Deposit Insurance for the Nineties, Meeting the Challenge* (Draft) (1989) ("FDIC 1989 Report to Congress") at 230.

[18] FDIC, *Mandate for Change: Restructuring the Banking Industry* 94 (Oct. 1987).

subsidiary." [19] Congress similarly failed to adopt a more limited source-of-strength assessment authority contained in a bill introduced by Congressman Barnard in 1987 that would have granted the federal banking regulators power to order a holding company to choose between adding capital to an inadequately capitalized subsidiary bank or divesting the bank.[20]

Again in 1988, Congress declined to grant the Board even a limited source-of-strength assessment power. That year, Senators Garn and Proxmire introduced S. 2715, the predecessor to the cross-guaranty provisions of FIRREA, which would have provided at least some statutory basis for a limited Board source-of-strength assessment authority. This bill would have amended section 5 of the BHC Act to authorize the Board, at the request of the FDIC, to require a bank holding company and its nonbank subsidiaries to contribute or transfer to any failing bank within the holding company system "such assets or services as are customarily utilized by a bank in the conduct of its business or operations." [21] The 1988 bill also would have granted power to the Board, at the request of the FDIC, to force a merger of affiliated banks. Board Chairman Greenspan recognized that the bill would "*establish*[] the principle that the financial strength of healthy segments of the system be used to bolster the capital or financial resources of a distressed banking affiliate." [22] In fact, Chairman Greenspan suggested that the hearing on the bill "*could explore whether* provision should be made to require the *nonbanking assets of the holding company* to be used to support an ailing bank affiliate." [23] The bill was not adopted.

In enacting FIRREA in 1989, Congress had before it a number of *alternative* proposals advanced by the federal bank regulatory agencies on how to treat problem banks within a multibank holding company system. These alternative proposals included the Board's proposed source-of-strength assessment authority, and the FDIC's "cross-guaranty" proposal that all the banks within a holding company system (but not the holding company itself or its nonbank affiliates) should be subject to assessment for any loss incurred by the FDIC in disposing of any failed bank within the system. These alternative proposals were summarized in a comprehensive FDIC report on the banking system [24] that the FDIC presented to each member of the House and Senate banking committees,[25] and that shaped congressional debate on FIRREA. While Congress was considering FIRREA, Congressman Barnard introduced a bill similar to his proposed 1987 legislation, that included a limited source-of-strength assessment power, under which a holding company would have had to choose between agreeing to add capital to an in-

[19] *Modernization of the Financial Services Industry: A Plan for Capital Mobility Within a Framework of Safe and Sound Baking*, H.R. Rep. No. 324, 100th Cong., 1st Sess. 48, 79-80 (1987).

[20] H.R. 3799, §101(d), 100th Cong., 1st Sess. (Dec. 18, 1987).

[21] S. 2715, 100th Cong., 2d Sess. § 2 (1988), *reprinted in* 134 Cong. Rec. S11,441 (daily ed. Aug. 10, 1988).

[22] *Oversight on the Condition of the Financial Services Industry: Hearings Before Senate Comm. On Banking, Housing and Urban Affairs*, 100th Cong., 2d Sess. 488 (1988) (letter from Alan Greenspan, Chairman of Federal Reserve Board, to Sen. William Proxmire (June 29, 1988)).

[23] *Id.*

[24] FDIC 1989 Report to Congress.

[25] *See Financial Condition of the Federal Savings and Loan Insurance Corporation and Federal Deposit Insurance Corporation at Year End 1988: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 612 (1989) (statement of L. William Seidman, Chairman, FDIC); *Financial Institutions Reform, Recovery and Enforcement Act of 1989 (H.R. 1278): Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 147 (1989) ("House FIRREA Hearings").

adequately capitalized subsidiary bank or divesting control of the bank.[26]

The FDIC, however, did not support Congressman Barnard's proposal. The FDIC argued in its 1989 Report to Congress that its "cross-guaranty" proposal was "the best alternative" for dealing with the issues raised by "problem banks" within a holding company system. By contrast, according to the FDIC, the Board's "source of strength" proposal had "*significant drawbacks compared to the other alternatives.*" [27] The FDIC concluded that the Board's source-of-strength assessment policy:

> will reduce market efficiency, limit the ability of banks to be viable competitors in the financial marketplace, and limit the ability to obtain new capital for the banking industry.[28]

According to the FDIC, "[c]ross-bank guarantees also *are preferable* to source-of-strength because they better preserve the distinctions between separate corporate entities within a holding company." [29] The FDIC concluded that its "cross-guaranty" proposal was "a more appropriate alternative" for dealing with problem banks within holding company systems than the Board's competing "source of strength" proposal.[30]

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[26] H.R. 1992 § 101(d), 101st Cong., 1st Sess. (Apr. 13, 1989).

[27] FDIC 1989 Report to Congress at 233 (emphasis supplied).

[28] *Id.* at 230.

[29] *Id.* at 231 (emphasis supplied). The FDIC maintained that by obliterating "the distinctions between the separate corporate entities within a holding company system," and placing a bank holding company's nonbank as well as bank assets at risk when a bank subsidiary fails, the Board's "source of strength" proposal would impede bank holding company expansion into nonbanking areas, inhibit nonbanking firm entry into the banking industry, reduce market efficiency and lead to unwarranted expansion of regulatory authority. *Id.* at 229-230.

[30] *Id.* at 230.

Congress agreed with and adopted the FDIC's cross-guaranty proposal, which is now codified in section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e). Congress did not, however, enact the Barnard source-of-strength proposal or include in FIRREA any other provision granting source-of-strength assessment authority to the Board.[31] This omission is particularly notable because the FDIC had expressly advised Congress that the legal validity of the Board's purported source-of-strength assessment authority was both untested and uncertain, and that Congressional enactment of such authority would "represent[] a *significant expansion* of bank regulatory authority." [32]

Congress again had the source-of-strength assessment issue before it in considering the Crime Control Act of 1990, Pub. L. No. 101-647, Nov. 29, 1990. On May 17, 1990, two days after the court of appeals decided the *MCorp* case, the Senate Banking Committee heard testimony on the Board's source-of-strength assessment policy and the *MCorp* decision, as well as the practice of the Office of Thrift Supervision ("OTS") of obtaining net-worth maintenance agreements from holding companies as a condition of their acquisition of a savings and loan association.[33] The court of appeals in *MCorp* expressly

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[31] The General Accounting Office has noted that section 206(e) of FIRREA "holds affiliated insured depository institutions liable for each other's losse *but does not extend this liability to holding companies unless they themselves are depository institutions.*" General Accounting Office, *Bank Powers: Report to the Chairman, Subcomm. on General Oversight and Investigations, House Comm. on Banking, Finance and Urban Affairs,* at 13 n.7 (Mar. 1990) (emphasis supplied).

[32] FDIC 1989 Report to Congress at 229, 231 (emphasis supplied).

[33] *Deposit Insurance Reform and Financial Modernization: Hearings Before Senate Comm. on Banking, Housing, and Urban Affairs,* No. 973, Vol. II, 101st Cong., 2d Sess. 236-45 (May 17, 1990) (statement of Lawrence Connell), *quoted in* 136 Cong. Rec. S13,825 (daily ed. Sept. 25, 1990).

noted this practice and suggested that the Board, therefore, was not without an adequate alternative to its alleged source-of-strength assessment authority. The court observed that "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial soundness." [34]

As adopted, Title XXVII of the Crime Control Act enhances the enforceability of capital maintenance commitments (of the sort discussed in footnote 5 of the court of appeal's decision) in bankruptcy proceedings by providing, among other things, for their nondischarge in bankruptcy.[35] That Act does not, however, grant the Board or the FDIC authority to make involuntary source-of strength assessments against holding companies. Specifically, Congress failed to enact legislation introduced by Senate Banking Committee Chairman Riegle that would have granted the FDIC, but not the Board, a limited source-of-strength assessment authority by extending the FDIC's cross-guaranty assessment power to reach the assets of a holding company and other nonbank affiliates of a bank up to a maximum of five percent of the bank's assets.[36]

The question of a source-of-strength assessment authority is again before Congress in at least two pending bills. Section 101(d) of H.R. 192, introduced in the House of Representatives by Congressman Barnard on

[34] Board Pet. App. at 21a n.5. Although the Board complains that this statement offers it "little solace" Board Pet. at 27 n.21, the fact is that the Board has long recognized and used its application "conditioning" authority to extract such agreements. Board, Bank Holding Company Supervision Manual § 204.0 (1982).

[35] Crime Control Act, § 2722, 136 Cong. Rec. S18,323 (daily ed. Nov. 2, 1990).

[36] S. 3103 § 10, 100th Cong., 2d Sess., *reprinted in* 136 Cong. Rec. S13,831 (daily ed. Sept. 25, 1990).

January 3, 1991, would grant the federal banking agencies power to require a holding company to "contribute to the surplus capital of the insured depository institution, an amount necessary to bring the insured depository institution into compliance with the applicable minimum required capital adequacy."

Similarly, Title VI of H.R. 6, entitled "Source of Strength," was introduced on January 3, 1991 by House Banking Committee Chairman Gonzalez. This bill would invest the FDIC with source-of-strength assessment authority by expanding the cross-guaranty provisions of the Federal Deposit Insurance Act to assess bank holding companies and their nonbank subsidiaries for losses incurred by the FDIC in the insolvency of an affiliated bank. Significantly, the bill would not vest any comparable assessment authority in the Board.

In addition, the administration's newly-released report containing recommendations to Congress for substantial revisions to the federal banking statutes, proposes new statutory authority for a *limited* source-of-strength assessment power, under which a bank holding company that controls a bank that fails to meet capital standards would have to choose between bringing the bank into capital compliance, divesting the bank, or subjecting itself and all of its bank and nonbank affiliates to bank-style capital requirements.[37]

Notably, there has been only one amendment to section 3(c) of the BHC Act adopted since *First Lincolnwood* affecting the Board's statutory authority to consider the financial and managerial strength of a holding company at the time it acquires a bank. In that amendment, Congress, in response to *First Lincolnwood*, *narrowed* the Board's authority to consider the holding company's strength by limiting the Board's power to disapprove the

[37] U.S. Treasury Department, *Modernizing the Financial System, Recommendations for Safer, More Competitive Banks* at 61 (February 1991). In this regard, the Treasury proposal is similar to Congressman Barnard's 1987 and 1989 draft legislation discussed above.

formation of one-bank holding companies on source-of-strength grounds.[38]

This extensive history of consideration and rejection of a number of varying formulations of a source-of-strength assessment authority demonstrates that Congress as of this date continues to reject the earlier regime of shareholder assessment statutes. The Board's policy arguments for investing it with a source-of-strength assessment power should continue to be addressed to Congress,[39] which is even now considering whether the Board or the FDIC should have some form of this authority.

C. The BHC Act Provides No Source-of-Strength Assessment Authority

In the face of this express repeal of shareholder assessments and repeated Congressional rejection of proposals to restore various forms of shareholder assessment authority, the Board is left to rely on implied authority it believes it finds in three banking statutes. None of these Acts, singly or collectively, restore the shareholder assessment powers repealed by Congress.

The Board primarily relies on section 3 of the BHC Act, which directs the Board to consider the financial and managerial resources of a company at *the time the company seeks permission to acquire a bank.* This is the only authority upheld in *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978). Neither that decision nor the BHC Act, however, contain any suggestion that the Board is authorized to assess a bank holding company for the losses of its subsidiary banks.

As the court of appeals observed, "*First Lincolnwood* is narrowly written and expressly limits the

[38] Depository Institutions Deregulation and Monetary Control Act, Pub. L. No. 221, § 713, 94 Stat. 190, 96th Cong., 2d Sess. (Mar. 31, 1980), *codified at* 12 U.S.C. § 1842(c) (limiting Board's power to disapprove, based upon loan on bank stock, an application to form a one-bank holding company).

[39] *See, e.g., Diamond* v. *Chakrabarty*, 447 U.S. 303, 317 (1980).

Board's authority to consider financial and managerial soundness of subsidiary banks to the Board's decision to grant or deny a holding company's application." Board Pet. App. at 20a. The court of appeals also noted that the BHC Act does not grant the Board authority to establish or enforce capital levels for, or otherwise regulate banks owned by a bank holding company.[40] The court of appeals correctly rejected the Board's attempt to transform and expand its narrow statutory authority to consider the financial soundness of a bank holding company in passing upon its application to acquire a bank, into the authority to assess a bank holding company for the losses of its subsidiary banks, at any time, without limit and without any fault on the part of the holding company.

The Board concedes that the alleged monetary assessment authority at issue here "extends the Supreme Court's holding, in . . . *First Lincolnwood Corp.*" [41] As noted by Justices Stevens and Rehnquist's dissenting opinion, the Court in *First Lincolnwood* limited its holding concerning the Board's authority to deny applications to acquire a bank to a small subset of those applications in which the "effect" of the proposed "transaction would have been the formation of a financially unsound bank holding company." [42]

In 1984, when the Board amended its Regulation Y to provide that a "bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks," [43] the Board made no suggestion that it

[40] Board Pet. App. at 20a-21a. The BHC Act does not grant the Board authority to regulate the activities of subsidiary banks of a bank holding company. *Independent Ins. Agents of America* v. *Board of Governors*, 890 F.2d 1275 (2d Cir. 1989), *cert. denied*, 111 S. Ct. 44 (1990).

[41] Board Suggestion for Rehearing *En Banc* at 7 in *MCorp* v. *Board of Governors*, No. 89-2816 (5th Cir. June 27, 1990).

[42] 439 U.S. at 252 n.18, 258 n.6. Even on this narrow ground, the dissent found the majority's reasoning unpersuasive.

[43] 12 C.F.R. § 225.4; 49 Fed. Reg. 794, 820 (1984).

created an enforceable and unlimited obligation on the part of a bank holding company to downstream all its available assets into subsidiary banks.[44] Indeed, in the Regulation Y rulemaking proceeding, the Board received no substantive comments from the public on this reiteration of its existing source-of-strength policy.[45]

In February 1987, in an administrative enforcement action brought against the Hawkeye Corporation,[46] the Board for the first time asserted that it could assess a bank holding company for the losses of its subsidiary banks. In April 1987, on the eve of the scheduled administrative hearing against Hawkeye, the Board dismissed its source-of-strength charges and simultaneously issued a "Policy Statement" proclaiming its new "policy" that: [47]

> [A] bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity.[48]

The Board stated in its Policy Statement that a failure to provide capital to a troubled or failing subsidiary bank would be viewed as a violation of Regulation Y and an unsafe and unsound practice, and that "[w]here necessary, the Board is prepared to take supervisory action to require such assistance." [49]

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[44] *See* 49 Fed. Reg. 794 (1984); 48 Fed. Reg. 23,520 (1983).

[45] 49 Fed. Reg. 800 (1984).

[46] *In re Hawkeye Corp.*, No. 87-003-B-HC (Notice of Charges and Hearing Before the Board of Governors of the Federal Reserve System) (Feb. 5, 1987); Keeton, *Bank Holding Companies, Cross-Bank Guarantees and Source of Strength,* Federal Reserve Bank of Kansas City Economic Review 54, 61 (May/June 1990).

[47] *See Fed Drops Case Against Hawkeye,* Am. Banker May 4, 1987 at 11; 52 Fed. Reb. 15,707 (Apr. 30, 1987) (emphasis supplied); Keeton, *Bank Holding Companies, Cross-Bank Guarantees and Source of Strength,* Federal Reserve Bank of Kansas City Economic Review 54, 61 (May/June 1990).

[48] 52 Fed. Reg. 15,707 (1987).

[49] 52 Fed. Reg. 15,708 (1987).

Not surprisingly, federal bank regulators other than the Board—*i.e.*, the FDIC, the Resolution Trust Corporation and the OTS—have, in litigation concerning whether capital maintenance commitments are enforceable in court as contracts or in administrative proceedings as regulatory conditions, taken the position that language in the Savings and Loan Holding Company Act virtually identical to the BHC Act language relied on by the Board does not authorize source-of-strength assessments against savings and loan holding companies.[50] According to the FDIC, "[n]othing in the detailed regulations pertaining to savings and loan holding companies (or in any other statute or regulation) obligated a holding company to maintain the insured institution's net worth." [51] Similarly, the Resolution Trust Corporation acknowledges that:

> the absence of any statute or regulation expressly requiring savings and loan holding companies to maintain the solvency of the insured institutions under their control was precisely why the FHLBB/FSLIC's used net worth maintenance agreements.[52]

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[50] *Compare* 12 U.S.C. § 1467a(e)(2) ("the Director [of OTS] shall take into consideration the financial and managerial resources and future prospects of the company and association involved") *with* 12 U.S.C. § 1842(a) ("the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned").

[51] Brief of Appellant FDIC at 29, *In Re Conner Corporation,* (E.D.N.C. Sept. 28, 1990 No. 90-488 Civ-5-BO) (footnote omitted) (copy lodged with Clerk of this Court).

[52] Brief of Appellant Resolution Trust Corporation at 22, in *Resolution Trust Corporation* v. *Savers* (8th Cir. Sept. 28, 1990 No. 90-2037EA). The enforcement staff of the Office of Thrift supervision takes the same position. OTS Enforcement Review Committee Resolution No. 89-127 at 2, in the Matter of Gary L. Akin, Sole Stockholder, Chairman and Former President of TexasBanc Savings, F.S.B. (Nov. 7, 1990). (Copies lodged with Clerk of this Court).

The fact that the Board did not "discover" its purported source-of-strength assessment authority until 31 years after the BHC Act was adopted casts substantial doubt on the existence of any basis in the BHC Act for the alleged authority.[53] Moreover, the Board cites to no instance in which it has enforced an involuntary source-of-strength assessment against a bank holding company.

D. ILSA Provides No Source-of-Strength Assessment Authority

The Board also asserts that ILSA supports the Board's claimed assessment powers. Board Pet. 23. To the contrary, ILSA expressly withholds from the Board authority to establish capital levels for subsidiary banks of a bank holding company. While ILSA authorizes federal bank regulatory agencies to establish minimum capital requirements for banks, that Act defines the Board as the appropriate federal banking agency *only* for "bank holding companies and any *nonbank* subsidiary thereof" (emphasis added).[54] Nor does ILSA grant any agency authority to order bank holding companies to transfer their funds into subsidiary banks. In fact, the Board's 1984 rulemaking proposal implementing ILSA made no mention of any purported authority to require holding companies to contribute capital to subsidiary banks.[55] The Board in issuing this statement acknowledged that it "believes that it serves no useful purpose to increase bank capital at the expense of its parent holding company." *Id.* Increasing bank capital at the expense of the holding company, however, is precisely what the Board is attempting to accomplish through prosecution of source-of-strength charges.

[53] *Cf. BankAmerica Corp.* v. *United States*, 462 U.S. 122, 130 (1983).

[54] 12 U.S.C. § 3902(1)(A) (defining "appropriate Federal banking agency" as meaning the Board for "(A) bank holding companies and any *nonbank* subsidiary thereof" (emphasis added)).

[55] 49 Fed. Reg. 30,317 (1984).

E. FISA Provides No Source-of-Strength Assessment Authority

The Board also suggests that its general authority under FISA, 12 U.S.C. § 1818, to exercise cease-and-desist powers to enjoin "unsafe and unsound" practices authorizes it to require a bank holding company to ignore its own separate corporate status and downstream its own assets into a subsidiary bank. Board Pet. at 3-4. It is clear, however, that "Congress never intended to give these agencies a 'blank check' authority" under the cease-and-desist provisions of section 1818.[56] Moreover, if Congress intended the federal banking agencies to have statutory authority under the cease-and-desist provisions of section 1818 to compel affiliates of a bank to inject capital into the bank, the enactment of section 206(e) of FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989), granting the FDIC express statutory authority to make "cross-guaranty" assessments against affiliated banks would have been unnecessary, because the FDIC and the Board already would have had such authority. The court of appeals correctly refused to permit the Board to use its general remedial powers to bootstrap its way into the substantive assessment authority denied it by Congress.

F. FIRREA Provides No Source-of-Strength Assessment Authority

The Board suggests that, after the district court's decision in this case, Congress in section 902 of FIRREA (amending 12 U.S.C. § 1818(b)) provided the Board statutory authority to make source-of-strength assessments against bank holding companies. Board Pet. at 4. Section 902 plainly and expressly relates to restitutionary-type remedies where an institution-affiliated party has acted in a "reckless" manner or "was unjustly enriched" at the expense of a financial institution. Section 902 has nothing whatsoever to do with the Board's alleged

[56] *Larimore* v. *Comptroller of the Currency*, 789 F.2d 1244, 1253 (7th Cir. 1986); *accord* S. Rep. No. 1482, 89th Cong., 2d Sess., *reprinted in* 1966 U.S. Code Cong. & Admin. News 3532, 3538.

authority to make and enforce capital calls on bank holding companies regardless of fault for the losses of their subsidiary banks. The Board's alleged source-of-strength assessment authority is not limited to losses caused by the reckless conduct or involving the unjust enrichment necessary to invoke the restitutionary remedies of section 902. Instead, the Board's purported source-of-strength assessment authority turns solely upon the fact that a bank holding company owns a bank that needs additional capital.

The Board's policy arguments in favor of a source-of-strength assessment power are not a substitute for the statutory authority denied it by Congress. Like any federal administrative agency, the Board possesses only the authority that Congress grants it by statute.[57] The Board may not unilaterally expand this authority based on its own interpretation of the "broad purposes" of the statutes it administers.[58] As this Court held in *Dimension Financial Corp.*, "[i]f the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts, to address." 474 U.S. at 374.

II. THE BOARD'S SOURCE-OF-STRENGTH ASSESSMENT POLICY IS VOID UNDER THE ADMINISTRATIVE PROCEDURE ACT

Even if the Board had statutory authority to adopt a source-of-strength assessment regulation (which, as discussed above, it does not), the Board's source-of-strength assessment Policy Statement is void and unenforceable

[57] *See, e.g., Coit Indep. Joint Venture* v. *FSLIC*, 489 U.S. 561 (1989); *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361 (1986); *American Bank & Trust Co.* v. *Federal Reserve Bank*, 256 U.S. 350 (1921); *Business Roundtable* v. *SEC*, 905 F.2d 406 (D.C. Cir. 1990); *Western Bancshares, Inc.* v. *Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

[58] *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986).

because it is a "substantive rule" adopted in violation of the notice-and-comment requirements of section 553 of the APA, 5 U.S.C. § 553.

In 1984, the Board adopted a regulation, 12 C.F.R. § 225.4(a), which used the phrase "source of strength" but which did not purport to create an enforceable obligation on the part of holding companies to infuse capital into subsidiary banks. The regulation merely codified prior Board statements that a bank holding company should serve as a source of strength to its subsidiary banks. None of these statements remotely suggested that holding companies were liable to make cash contributions to subsidiary banks. In adopting this regulation, the Board stated that "bank holding companies should observe the statements of policy issued by the Board from time to time concerning supervisory and other matters." [59]

In 1987, without any prior notice or opportunity for comment, the Board published a press release containing such a statement of policy which *does* purport to create an enforceable obligation to infuse capital into subsidiary banks, but which was not adopted in accordance with the notice and comment procedures required by the APA. The source-of-strength assessment Policy Statement does not appear anywhere in the Code of Federal Regulations. Indeed, it is not even published in Regulation Y with the other Board policy statements and interpretations concerning bank holding companies.

The source-of-strength Policy Statement was adopted by publication [60] effective as of a date six days before the publication date. In response to the Policy Statement, the Board received several comments challenging its ac-

[59] 48 Fed. Reg. 23,520, 23,523 (1983). The Board cannot lawfully issue a regulation which reserves for itself the authority to ignore the notice and comment requirements of section 553 of the APA when adopting future substantive changes in the regulation. Such an attempt would be a transparent evasion of the requirements of the APA.

[60] 52 Fed. Reg. 15,707 (1987).

tion on the grounds that the Policy Statement, without benefit of statutory authority, effected a substantial enlargement of a bank holding company's financial liability to its subsidiary banks.[61] The 1987 Policy Statement has never been revised or republished to reflect public comments.

Section 553 of APA requires that "substantive rules" be adopted by "notice-and-comment" procedure. Under this procedure, the required publication must be made at least 30 days prior to the effective date of the rule, and interested parties must be permitted to comment on the proposed rule *before* it is adopted by the agency.

The 1987 source-of-strength assessment rule cannot escape the notice-and-comment requirements of section 553 on a theory that it was promulgated through a release labeled a "Policy Statement" by the Board. The exceptions to the notice-and-comment requirements of section 553 for "interpretive rules" and "policy statements" are narrowly construed. The courts are not bound by the agency's labeling of a substantive rule as a "policy statement" or "interpretive rule."[62] Any rule that establishes binding norms, affects particular rights and obligations, has a substantial impact on a regulated industry, effects a change in existing law or policy, or creates new law, is a "substantive rule" that can be adopted only by the notice-and-comment procedure of section 553.[63]

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[61] *See* Letter from Richard S. Simmons, Chemical New York Corporation to Board (June 4, 1987); Letter from Peter Carlson to Board (June 26, 1987); Letter from Duke Financial Group, Inc. to Board (June 26, 1987); Letter from Baird, Hold, McEachen, Pedersen, Hammann & Strasheim (submitted on behalf of Hawkeye Bancorporation) to Board (June 30, 1987); Letter from Gary A. Speiss, General Counsel, Bank of Boston, to Board (June 30, 1987) (available in Board Docket No. R-0602).

[62] *Brown Express, Inc.* v. *United States*, 607 F.2d 695, 700 (5th Cir. 1979).

[63] *See, e.g., Chrysler Corp.* v. *Brown*, 441 U.S. 281, 312-13 (1979); *Alcaraz* v. *Block*, 746 F.2d 593, 612 (9th Cir. 1984); *Dep't of Labor* v. *Kast Metals Corp.*, 744 F.2d 1145, 1152 (5th Cir. 1984);

The source-of-strength Policy Statement is a "substantive rule" because, by purporting to impose an enforceable unlimited obligation on bank holding companies to supply capital to subsidiary banks, it affects a change in the law, with a substantial impact on bank holding companies and their shareholders and creditors. Because 12 C.F.R. § 225.4(a) does not purport to authorize forced downstreaming of bank holding company capital into subsidiary banks, the 1987 Policy Statement cannot reasonably be deemed an interpretation of section 225.4(a).

"Substantive rules" such as the Policy Statement, adopted in violation of section 553 of APA are not enforceable.[64] As this Court has held:

> Certainly regulations subject to the APA cannot be afforded the 'force and effect of law' if not promulgated pursuant to the statutory procedural minimum found in that Act. Section 4 of the APA, 5 U.S.C. § 553, specifies that an agency shall afford interested persons general notice of proposed rulemaking and an opportunity to comment *before* a substantive rule is promulgated.[65]

Thus, even if the Board did have statutory authority to empower itself with a source-of-strength assessment authority (which it clearly does not), the Board's failure to adopt this authority as a substantive rule under the procedures dictated by the APA renders it void and unenforceable.

American Federation of Gov't Employees v. *Block*, 655 F.2d 1153, 1156 (D.C. Cir. 1981); *Pacific Gas & Elec. Corp.* v. *FPC*, 506 F.2d 33, 38-39 (D.C. Cir. 1974); *Washington Fed. Sav. & Loan Ass'n* v. *FHLBB*, 526 F. Supp. 343, 383 (N.D. Ohio 1981).

[64] *See, e.g., Cerro Metal Products* v. *Marshall*, 620 F.2d 964, 981-83 (3d Cir. 1980); *Detroit Edison Co.* v. *EPA*, 496 F.2d 244, 249 (6th Cir. 1974); *Guardian Fed. Sav. & Loan Ass'n* v. *FSLIC*, 589 F.2d 658, 664-65 (D.C. Cir. 1978).

[65] *Chrysler Corp.*, 441 U.S. at 313. (emphasis supplied, citations omitted).

III. THE COURT OF APPEALS PROPERLY INSTRUCTED THE DISTRICT COURT TO ENJOIN THE PROSECUTION OF THE BOARD'S SOURCE-OF-STRENGTH CHARGES

A. 12 U.S.C. § 1818(i) Did Not Bar The Court of Appeals From Remanding With Instructions to Enjoin Unlawful Agency Action

As demonstrated above, the Board is utterly devoid of authority to levy monetary assessments against bank holding companies on the basis of its source-of-strength Policy Statement. The Board, however, argues that 12 U.S.C. § 1818(i) barred the court of appeals from directing the district court to enjoin the Board's source-of-strength assessment proceeding. Section 1818(i) provides:

> [E]xcept as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order.

12 U.S.C. § 1818(i)(1).

Section 1818(i) does not shelter the Board's *ultra vires* action to enforce its invalid source-of-strength assessment policy. Established Supreme Court authority and the prior rulings of the courts of appeal make clear that a statute, such as section 1818(i), that prescribes a general procedure for judicial review, does not bar a court's jurisdiction to enjoin an administrative proceeding that is beyond the authority of the administrative agency. *Leedom* v. *Kyne*, 358 U.S. 184, 190 (1958); *Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973). Indeed, the Fourth Circuit has ruled that the holding in "*Leedom* v. *Kyne requires* that a federal court ascertain whether an administrative agency is acting within its authority. . . ." *Champion Int'l Corp.* v. *EPA*, 850 F.2d 182, 186 (4th Cir. 1988) (emphasis added); *see also Dart* v. *United States*, 848 F.2d 217, 221 (D.C. Cir. 1988) ("Judicial review is favored when an agency is charged with acting beyond its authority.")

In *Manges* v. *Camp*, 474 F.2d 97, 99 (5th Cir. 1973), the Fifth Circuit specifically applied the *Leedom* v. *Kyne* doctrine to section 1818(i) and stated:

> There is . . . a very strong court created exception to withdrawal statutes. This exception comes into play when there has been a clear departure from statutory authority, and thereby exposes the offending agency to review of administrative action otherwise made unreviewable by statute.

Thus the court held that, under the doctrine of *Leedom* v. *Kyne*, section 1818(i) was inapplicable because the order at issue exceeded the Comptroller's statutory authority in that it prohibited a bank shareholder from voting his shares or participating in the management of the bank based upon conduct not covered by the Comptroller's removal authority.[66]

Because the Board has no statutory authority to make a source-of-strength assessment against a bank holding company, there is no substance to the Board's contention that the court of appeals was constrained to await the completion of the Board's source-of-strength proceedings and the issuance of a final assessment order against MCorp before interdicting the proceeding. As the Fourth Circuit has confirmed:

> If an agency acts in clear derogation of its statutory authority, a court need not wait for the underlying proceedings to conclude to intervene. *Leedom* v. *Kyne*, 358 U.S. 184, 188, 79 S. Ct. 180, 183, 3 L. Ed. 2d 210 (1958).

Gracey v. *Local 1340 International Brotherhood of Elec. Workers*, 868 F.2d 671, 674 n.1 (4th Cir. 1989).

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[66] *See also Graham* v. *Caston*, 568 F.2d 1092, 1097 (5th Cir. 1978) ("[i]f an administrative official clearly departs from statutory authority, the administrative action is subject to judicial review even though a jurisdictional withdrawal statute is otherwise applicable."); accord, *MidAmerica Bancorp* v. *Board of Governors*, 523 F. Supp. 568, 574 (D. Minn. 1980) ("The language [of section 1818(i)] cannot be read literally, however. It must yield to an interpretation that permits a district court to enjoin Board actions that clearly exceed its statutory authority.")

B. Exhaustion Doctrine Is Inapplicable

Conceding that section 1818(i) does not constitute a "jurisdictional bar", Board Pet. 20, the Board invokes the doctrine of exhaustion of administrative remedies. Board Pet. 22. As demonstrated by the cases cited in the preceding section, that doctrine is irrelevant to a proceeding beyond the authority of the agency. Moreover, requiring MCorp to exhaust its administrative remedies would advance none of the purposes served by the exhaustion doctrine. The compiling of a factual record, the proper framing of issues in dispute, permitting the agency to apply its expertise, and the efficient administration of justice are common rationales for the exhaustion requirement.[67] Such rationales do not apply here because, as the court of appeals noted, no facts are disputed, the issue is a purely legal one concerning the alleged statutory authority of the Board to levy monetary assessments against holding companies, the courts are expert in matters of statutory interpretation, and the prompt judicial resolution of the dispute eliminates unnecessary administrative proceedings and is in the interest of efficient judicial administration.[68] This Court, on a number of occasions, has ruled that exhaustion is not necessary when the dispute concerns a purely legal issue.[69]

C. 28 U.S.C. § 2106 Authorized The Court of Appeals to Direct the Entry of an Injunction Against the Board's Unlawful Source-of-Strength Proceeding

An independent grant of appellate jurisdiction affirms the authority of the court of appeals to direct the entry

[67] *McKart* v. *United States*, 395 U.S. 185, 193-201 (1969); *Consumers Union of the United States, Inc.* v. *Cost of Living Council*, 491 F.2d 1396, 1399 (Temp. Emer. Ct. App. 1974).

[68] Board Pet. App. at 15a.

[69] *See e.g., McKart*, 395 U.S. at 197-99; *Gardner* v. *Toilet Goods Ass'n*, 387 U.S. 167, 171 (1967); *see also, Frontier Airlines, Inc.* v. *Civil Aeronautics Bd.*, 621 F.2d 369, 371 (10th Cir. 1980); *National Automatic Laundry and Cleaning Council* v. *Schultz*, 443 F.2d 689, 695 (D.C. Cir. 1971); *Shell Oil Co.* v. *Federal Energy Adm'n*, 400 F. Supp. 964, 968 (S.D. Tex.), *aff'd*, 527 F.2d 1243 (Temp. Emer. Ct. App. 1975).

of an injunction against the Board's source-of-strength assessment proceeding. Specifically, 28 U.S.C. § 2106 provides that any "court of appellate jurisdiction may affirm, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review, and may remand the cause and direct the entry of such appropriate judgment, decree, or order, or require such further proceedings to be had as may be just under the circumstances."

Appellate courts have invoked jurisdiction under section 2106 "in the interest of judicial economy."[70] Indeed, "to obviate further and entirely unnecessary proceedings below," this Court in *Grosso* v. *United States*, 390 U.S. 62, 71-72 (1968), reversed certain convictions on the basis of 28 U.S.C. § 2106 rather than vacating those convictions. As in *Grosso*, the court of appeals resolved a clear legal issue properly before it, and lawfully directed the district court to enjoin the prosecution of the proceedings that were *ultra vires*. Had the court of appeals remanded to the Board, the inevitable consequence would have been the issuance of a source-of-strength assessment against MCorp followed by a challenge, *in the very same court of appeals*, to the legality of such a source-of-strength assessment order. Such a course would have produced only delay and a waste of judicial resources.[71]

Finally, the appropriateness of the court of appeals resolving the source of strength issue is underscored by

[70] *Government of the Virgin Islands* v. *Smith*, 445 F.2d 1089, 1095 (3d Cir. 1971).

[71] *Grosso*, 390 U.S. at 71-72; *Levin* v. *Mississippi River Fuel Corp.*, 386 U.S. 162, 170 (1968); *In re Hronek*, 563 F.2d 296, 298 (6th Cir. 1977); *Independent Bankers Ass'n* v. *Heimann*, 613 F.2d 1164, 1167 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980).

Contrary to the Board's assertion, Board Pet. at 18 n.15, the absence of a cross-appeal did not deprive the court of appeals of jurisdiction, particularly in view of the fact that the source-of-strength assessment issue was briefed both before the district court and the court of appeals. *See Dayton Board of Ed.* v. *Brinkman*, 433 U.S. 406, 418-19 (1977); *United States* v. *American Ry. Express Co.*, 265 U.S. 425, 433, 435-36 (1924); *In re Swine Flu Immunication Products Liability Litig.*, 880 F.2d 1439, 1444 (D.C. Cir. 1989).

the fact that no practical purpose would be served by this Court's reviewing the Board's jurisdictional argument. Even if that argument were valid, MCorp still would obtain an early judicial ruling on the invalidity of the Board's asserted source of strength assessment authority through an alternative jurisdictional route—namely review of the outstanding temporary cease-and-desist orders issued against MCorp at the outset of this proceeding. *See* Board Pet. at 8-9.[72]

CONCLUSION

For the reasons stated herein, the Board's petition for certiorari should be denied.

Respectfully submitted,

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[72] The United States district courts have jurisdiction to issue an injunction "setting aside, limiting, or suspending" a temporary cease-and-desist order. 12 U.S.C. § 1818(c)(2). MCorp timely appealed from the temporary orders, which appeal the district court stayed for the duration of the preliminary injunction issued in this proceeding.

APPENDIX

STATUTORY PROVISIONS INVOLVED

Section 22 of the Banking Act of 1933, formerly codified at 12 U.S.C. § 64a:

> SEC. 22. The additional liability imposed upon shareholders in national banking associations by the provisions of section 5151 of the Revised Statutes, as amended, and section 23 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 63 and 64), shall not apply with respect to shares in any such association issued after the date of enactment of this Act.

Section 304 of the Banking Act of 1935, formerly codified at 12 U.S.C. § 64a:

> SEC. 304. Section 22 of the Banking Act of 1933, as amended, is amended by adding at the end thereof the following sentences: "Such additional liability shall cease on July 1, 1937, with respect to all shares issued by any association which shall be transacting the business of banking on July 1, 1937: *Provided*, That not less than six months prior to such date, such association shall have caused notice of such prospective termination of liability to be published in a newspaper published in the city, town, or county in which such association is located, and if no newspaper is published in such city, town, or country, then in a newspaper of general circulation therein. If the association fail to give such notice as and when above provided, a termination of such additional lability may thereafter be accomplished as of the date six month subsequent to publication, in the manner above provided."

Section 2 of the Act of May 18, 1953, formerly codified at 12 U.S.C. § 64a.

> SEC. 2. Section 22 of the Banking Act of 1933, as amended, is hereby amended by adding at the end

thereof the following sentence: "In the case of each association which has not caused notice of such prospective termination of liability to be published prior to the effective date of this amendment, the Comptroller of the Currency shall cause such notice to be published in the manner provided in this section, and on the date six months subsequent to such publication by the Comptroller of the Currency such additional liability shall cease."

Section 7 of the Act of Sept. 8, 1959:

SEC. 7. Section 5151 of the Revised Statutes (12 U.S.C. 63) and section 23 of the Federal Reserve Act (12 U.S.C. 64) are repealed.

Section 553 of the Administrative Procedure Act, 5 U.S.C. § 553:

§ 553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

(3)

No. 90-913

In the Supreme Court of the United States

OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

REPLY BRIEF FOR THE PETITIONER

KENNETH W. STARR
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Department of Justice
Washington, D.C. 20530
(202) 514-2217

TABLE OF AUTHORITIES

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In the Supreme Court of the United States

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No. 90-913

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REPLY BRIEF FOR THE PETITIONER

In this case, the court of appeals held that the Federal Reserve Board "exceeded its statutory authority" in promulgating and enforcing its source of strength regulations with respect to bank holding companies. Pet. App. 2a. In our petition, we demonstrated that the court of appeals has erroneously invalidated a longstanding, frequently invoked, and critically important federal regulatory tool for safeguarding the stability of the Nation's banking institutions. Moreover, we showed that the court of appeals effectively reached out to nullify the Board's policy by misappropriating jurisdiction under the doctrine set forth in *Leedom* v. *Kyne*, 358 U.S. 184 (1958). The court did so despite FISA's explicit preclusion provision, namely, that "no court shall have jurisdiction to affect * * * any notice or order" issued under FISA "except as otherwise provided in [12 U.S.C. 1818]." 12 U.S.C. 1818(i)(1). In response, MCorp seeks to minimize both the importance of the substantial issues presented and the waywardness of the court of appeals' decision. MCorp's efforts fall short of the mark.

1. MCorp asserts (Br. in Opp. 4, 11-13) that the FDIC's newly minted authority under the "cross-guaranty" provisions of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), 12 U.S.C. 1815(e), renders the Board's source of strength authority unimportant to the Nation's banking system. MCorp is wrong. First, the Board's authority includes the power to require holding companies to use all their available assets – including those derived from *nonbank* affiliates – to support weakened bank subsidiaries. The FDIC, however, can reach only assets of other banking subsidiaries. And that power has marginal utility where, as here, most of the holding company's banking subsidiaries are already strapped.[1]

Second, the Board, unlike the FDIC, can take remedial measures utilizing bank holding company assets before a bank default takes place. The Board's source of strength policy, unlike the FDIC's authority, is not confined to mitigating losses that have already occurred. Rather, the Board may apply its policy to prevent bank insolvencies by compelling holding companies to use their assets to protect the capital adequacy of subsidiary banks.[2]

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[1] In this case, 20 of MCorp's 25 subsidiary banks were declared insolvent, and three of the five remaining open banks already had capital reserves below minimum regulatory requirements.

Indeed, in the recent collapse of another large bank holding company system, the Bank of New England, all of the holding company's subsidiary banks were declared insolvent and placed under the FDIC's receivership. In such circumstances, the FDIC's cross-guaranty authority under FIRREA has little practical significance in preventing the failure of such banks.

[2] MCorp asserts (Br. in Opp. 14-15) that recent proposals before Congress to clarify the Board's source of strength authority show that the validity of such authority does not warrant this Court's review. To the extent Congress does consider such proposals, such legislative activity – in the face of the recently enacted provisions of FIRREA – would confirm that the Board's authority is anything but the sort of inconsequential issue to the Nation's banking system MCorp suggests.

In addition, MCorp seeks to belittle the Board's source of strength regulations by asserting that the Board "did not 'discover' its purported source-of-strength authority until [1987]." Br. in Opp. 20. As we previously pointed out (Pet. 15 & n.13), the Board has long relied on such authority in undertaking negotiations and other informal supervisory actions calculated to obtain a holding company's cooperation in ensuring that banking subsidiaries remain adequately capitalized.

2. MCorp's defense of the court of appeals' invocation of jurisdiction under *Leedom* v. *Kyne*, in the face of the exclusive judicial review provisions of FISA, 12 U.S.C. 1818(i), amounts to nothing more than labelling the Board's proceedings "*ultra vires* action." Br. in Opp. 26. Such a conclusory position, however, cannot be squared with this Court's recognition that "the painstakingly delineated boundaries of *Kyne*" make the "*Kyne* exception [to statutory judicial review provisions] * * * a narrow one." *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 481 (1964); see *Brotherhood of Ry. & S.S. Clerks* v. *Association for the Benefit of Non-Contract Employees*, 380 U.S. 650, 660 (1965).

Moreover, the court of appeals acknowledged (Pet. App. 21a-22a) that the Board's authority to promulgate and enforce its source of strength regulations ultimately turned on application of the framework of *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The very existence of such an issue under *Chevron* presupposes that Congress has not spoken to the precise question at hand, and that the agency therefore has the jurisdiction and delegated authority to construe the meaning of the statutory provision. For that reason, the court of appeals' invocation of *Leedom* v. *Kyne* is indefensible.

As an alternative basis of jurisdiction, MCorp invokes the broad powers of appellate review set forth in 28 U.S.C.

2106. See Br. in Opp. 28-30. That provision, however, is not an independent source of jurisdiction. In any event, this Court has long held that "[a]n appellate federal court must satisfy itself not only of its own jurisdiction, but also that of the lower courts in a cause under review." *Mitchell* v. *Maurer*, 293 U.S. 237, 244 (1934). Since FISA, 12 U.S.C. 1818(i), otherwise deprived the district court of jurisdiction to review the Board's pending proceedings, the power conferred on courts of appeals under 28 U.S.C. 2106 may not cure the district court's lack of subject matter jurisdiction.

MCorp's last-ditch effort to defend the court of appeals' exercise of jurisdiction is not a defense at all. MCorp merely asserts (Br. in Opp. 30 & n.72) that a pending action in another district could find its way to the court of appeals. Federal jurisdiction is determined by the particular circumstances of the case before the court, not by speculation as to whether similar issues might properly be presented by a different case pending in a different forum. And considerations of so-called "judicial economy," however laudable in other contexts, contrary to MCorp's suggestion, Br. in Opp. 29, may not be substituted for statutory prerequisites to jurisdiction.

3. MCorp's scattershot attack on the Board's authority to promulgate and enforce its source of strength regulations fails to come to grips with the language of the statutory provisions undergirding the Board's policy. See Pet. 23-29 (discussing provisions of the BHCA, FISA, and ILSA).[3] Instead, MCorp principally contends (Br. in Opp. 5-9) that the so-called "shareholder assessment" provisions of the

[3] For example, MCorp tries to make much out of the FDIC's evident disagreement – as a matter of policy – with the Board's source of strength regulations. See Br. in Opp. 5-6, 9-16. Congress has vested the Federal Reserve Board, not the FDIC, with the authority to regulate bank holding companies.

National Banking Act, which Congress repealed over 30 years ago, show that Congress had no intention of conferring similar authority on the Board under the guise of source of strength regulations.

First, actions of the Congresses that repealed provisions of the National Bank Act have no bearing on this case, since those Congresses assuredly did not enact the statutory provisions at issue, namely, the pertinent aspects of the BHCA, FISA, and ILSA. Second, MCorp's equating the regulatory regimes of "shareholder assessment" and source of strength is a sleight of hand. Under the National Bank Act, shareholder assessments were to be collected only after the bank had failed, in order to reduce losses incurred by the bank's creditors.[4] The Board's source of strength policy, in stark contrast, is prophylactic. That policy seeks to prevent bank failures – and the resulting losses to depositors and other creditors – by requiring the bank's parent holding company to provide needed capital before the bank fails.

4. Finally, MCorp contends that the Board's source of strength policy "is void and unenforceable because it is a 'substantive rule' adopted in violation of the notice-and-comment requirements of section 553 of the APA, 5 U.S.C. § 553." Br. in Opp. 22-23. In asserting this argument before this Court, MCorp neglects to mention that such a claim was never presented to either the district court or the court of appeals. For that reason alone, MCorp's claim is not properly before the Court. *E.g.*, *Demarest* v. *Manspeaker*, 111 S. Ct. 599, 602-603 (1991); *United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970). Moreover, since the merits of MCorp's APA claim cannot be reviewed in the absence of an adequate record regarding the Board's enforcement

[4] See Act of June 3, 1864, ch. 106, §§ 12, 50, 13 Stat. 102-103, 114-115; see also Act of Dec. 23, 1913, ch. 6, § 23, 38 Stat. 273.

efforts in this area, MCorp may not find a safe harbor in the Court's practice allowing a respondent to "rely upon any matter appearing in the record in support of the judgment below." *Blum* v. *Bacon*, 457 U.S. 132, 137 n.5 (1982); see *Schweiker* v. *Hogan*, 457 U.S. 569, 585 & n.24 (1982).

In any event, MCorp errs in branding the Board's source of strength policy as a substantive rule under the APA. The Board's policy did not in fact create new substantive obligations. Instead, the 1987 policy statement codified and clarified existing agency practices developed over the course of the Board's enforcement activities. See Pet. 15 & n.13.

* * * * *

For the foregoing reasons and those stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

KENNETH W. STARR
Solicitor General

FEBRUARY 1991

U.S. GOVERNMENT PRINTING OFFICE: 1991—282-061/20399

(4) (3)

Nos. 90-913 and 90-914

In the Supreme Court of the United States

OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI IN No. 90-913
FILED DECEMBER 10, 1990
PETITION FOR WRIT OF CERTIORARI IN No. 90-914
FILED DECEMBER 10, 1990
CERTIORARI GRANTED MARCH 4, 1991

In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-913

'BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

No. 90-914

MCORP, ET AL., PETITIONERS

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, MCORP FINANCIAL, INC., and MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS, and OFFICIAL CREDITORS' COMMITTEE, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

DOCKET ENTRIES

Date	Nr.	Proceedings
5-12-89		Received copy of Recommendation from Bkcy Court Signed by Judge Clerk.
5-12-89	2	(LNH) ORDER WITHDRAWING REFERENCE, filed. Counsel ntfd. cc/bkcy Reference to US Bankruptcy Court is withdrawn for Adversary No. 89-0298.
5-17-89	3	(LNH) ORDER FOR HEARING, entered. bj parties ntfd The hearing on MCorp's application for a preliminary injunction is set: June 1, 1989 at 2:00 p.m. Courtroom #7, 11th floor.
5-24-89	4	Creditors Committee UNOPPOSED MOTION for Intervention, filed
5-24-89	5	Memorandum in Support of Unopposed Motion for Intervention of The Official Creditors' Committee of MCorp Financial Inc. and MCorp Management, filed. bj

Date	Nr.	Proceedings
5-24-89		Rec'd 3 MOTIONS AND ORDERS PURSUANT TO LR1 for Robert J. Rosenberg, John P. Lynch and Deborah C. Paskin, fwd/crd.
5-2-89	6	ORIGINAL COMPLAINT, filed.
5-2-89	7	AFFIDAVIT OF GENE H. BISHOP IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING OR-ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	8	PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	9	Pltfs MCorp's EMERGENCY MOTION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 65 AND BANKRUPTCY RULE 7065 FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-2-89	10	COMPREHENSIVE SCHEDULING, PRETRIAL AND TRIAL ORDER, entered. Parties notified. Pre-trial conference scheduled for January 9, 1990, at 2:00 PM. Trial to be held week of January 15, 1990. See Order for schedule of filing dates.
5-3-89	11	(LZClark) ORDER DENYING APPLICATION FOR TEMPORARY RESTRAINING ORDER AND SETTING HEARING ON APPLICATION FOR PRELIMINARY INJUNCTION, entered. Parties notified. Ordered, TRO denied.

Date	Nr.	Proceedings
		Ordered, hearing on Pltfs' App. f/Pre Inj. set for May 11, 1989, at 10:00 AM. Ordered, Pltfs' file instruments by May 5, 1989 @ 4:30 PM. Ordered, Pltfs responsible for notice of contents of this Order to Respondent by 5-5-89 at 3:30 PM.
5-3-89	12	CERTIFICATE OF SERVICE, filed. Served 5-2-89.
5-3-89	13	CERTIFICATE OF TELEPHONIC NOTICE, filed. Deputy Clerk Hill telephoned Kimberly Pinuiolo and D.J. Baker concerning Application for Preliminary Injunction.
5-4-89	14	CERTIFICATE OF SERVICE OF ORDER DENYING APPLICATION FOR TEMPORARY RESTRAINING ORDER AND SETTING HEARING ON APPLICATION FOR PRELIMINARY INJUNCTION, filed. Served 5-3-89, by Richard J. Goodier, atty for MCorp.
5-4-89	15	EXPEDITED MOTION OF DEFENDANT THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR ENTRY OF ORDER STAYING PROCEEDINGS filed.
5-5-89	16	STATEMENT OF ISSUES, by Pltfs MCorp, filed.
5-8-89	17	(LZClark) ORDER, entered. Parties notified. Ordered, proceedings are stayed until further order of this Court or US Dist. Court for S. Dist. of Tx. with respect to the Board's motion for withdrawal of the reference.

Date	Nr.	Proceedings
5-10-89	18	Manufacturers Hanover Trust Company, as Indenture Trustee and Banco Atlantico, S.A.'s MOTION IN INTERVENTION, filed.
5-11-89	19	RECOMMENDATION FROM THE BANKRUPTCY COURT TO THE U.S. DISTRICT COURT ON THE MOTION OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE U.S. OF AMERICA FOR WITHDRAWAL OF REFERENCE ON ADVERSARY PROCEEDING 89-2098-H3.
5-11-89	20	Stephanie M. Morris' AFFIDAVIT OF SERVICE, filed.
5-11-89	21	COURTROOM MINUTES, United States Bankruptcy Court, filed. Re: Adversary 89-0298-H3: Preliminary Injunction. No hearing held; reference withdrawn by U.S. District Judge Hughes.
5/26/89	22	Deft's MEMORANDUM OF LAW in Opposition to Pltfs' Motion f/Preliminary Injunction, filed.
5/31/89	23	(LNH) ORDER, entered, Parties ntfd. br. Official Creditors Committee of MCorp, MCorp Financial, Inc. & MCorp Management is authorized to intervene in the proceeding & prosecute its compl. in Intervention.
5/31/89	24	COMPLAINT IN INTERVENTION of Official Creditors' Committee of MCorp, MCorp Fininacial, Inc. & MCorp Management, filed.
5-31-89	25	INTERVENOR OFFICIAL CREDITORS' COMMITTEE OF MCORP, MCORP FINANCIAL INC., AND MCORP MAN-

Date	Nr.	Proceedings
		AGEMENT'S MEMORANDUM IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION, filed.
5-31-89	26	PLAINTIFFS' REPLY MEMORANDUM OF LAW IN SUPPORT OF EMERGENCY MOTION FOR PRELIMINARY INJUNCTION, filed.
6/5/89	27	(LNH) ORDER enterd, parties notfd. jd Motionf to intervene by Manufacturere Hanover Trust Company and Banco Atlatico, S.A. re DENIED as moot.
6/5/89	28	(LNH) ORDER entered, parties notfd. jd Preliminary Inuunction Against the Federal Reserve System's Proceeding Administratively against MCorp. Status Conf. set for Aug. 15, 1989 at 10:00 a.m. (See Order for complete details)
6/1/89		Recvd. & forwarded to CRD Motion and Order Pursuant to LR 1
6/1/89	29	PLAINTIFFS' MOTION FOR LEAVE TO FILE DOCUMENTS UNDER SEAL AND TO PROTECT CONFIDENTIAL INFORMATION, filed M/D 6/26/89 by clerk
6/1/89	30	AFFIDAVIT of H. N. Cayne in Support of Emergency Motion f/Preliminary Injunction, filed.
6-1-89	31	(LNH) MINUTES OF INJUNCTION HEARING, filed. (rptr: Lauchner) Appearances: for Pltf: Baker, Miller, Fife, Barret, Case, Greg; for Deft: Stodgbill, Ashton, Pignuota, Strout, Hanlon, Parkins, Hanlon. See order for attorneys ad-

Date	Nr.	Proceedings
		mitted pro hac vice. Motion to Intervene of Manufacturers Hanover Trust and Bank Atlantico WITHDRAWN. Stipulation to exhibits admitted.
6-1-89	32	STIPULATION AS TO ADMISSION OF EXHIBITS, filed.
6-7-89	33	(LNH) ORDER, entered. Parties ntfd. These attorneys are admitted pro hac vice: Robert Rosenberg, Deborah Paskin, Charles Stodghill, Richard Ashton, Howard Cayne, Kevin Barret, Laurie Fife, Alan B. Miller, Dudley Murrey.
6-9-89	34	(LNH) OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FED. RESERVE SYSTEM, entered Parties ntfd. The board will be enjoined from processing its claims against the Debtor except through the bankruptcy court. (See Order f/details)
6-2-89	35	(LNH) Injunction Hearing (Day 2), filed. Reporter: Lauckner. Appearances: Same as 6-1-89. Record partially sealed. Injunction issued. (See Separate Order).
6-21-89	36	Answer Deft the Board of Governors of the Federal Reserve System, filed.
6-23-89	37	(LNH) PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM'S PROCEEDING ADMINISTRATIVELY AGAINST MCORP, entered. parties ntfd Under emergency scheduling, the parties may seek modification of this order after notice to the parties. The trial will not be set until the bankruptcy court has had a reasonable opportunity to address the issues raised by MCorp having subsidiaries banks and

Date	Nr.	Proceedings
		non-banks. A status conference is set for Aug. 15, 1989 at 10:00 a.m. Tues.
6-23-89	38	(LNH) OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM, entered. bj parties ntfd See Order for Details.
6-28-89	39	TRANSCRIPT OF PROCEEDINGS BEFORE THE HONORABLE LYNN HUGHES, filed. Proceedings held June 1, 1989 @ 1:30 PM. Loose in filed.
7-26-89	40	Deft. Board of Governors of the Federal Rexerve System NOTICE OF APPEAL to Order entered Jun 5, 1989, filed. Dkt'd 8-15-89
8-4-89	41	Deft. Board of Governors of the Federal Reserve System TRANSCRIPT ORDER FORM advising that the transcript is already on file, filed.
6-19-90		Rec'd Order Modifying Injunction Against Certain Administrative Proceedings by the Federal Reserve System Against MCorp, fwd/crd
8-16-89	42	(LNH) MINUTES OF HEARING, filed. (Rptr: Jeanette Byers) Appearances: for Pltf: Baker, Miller, Stroube, Rosenberg for Deft: Stodghill, Ashton, Pignuolo. The Court shall be kept informed of any proceedings in Bankruptcy Court that obviate the need for the injunction in this case.
8-17-89		RECORD ON APPEAL consisting of All Original Papers (4 Vols. & 1 Expandable Folder-attach. #35-Sealed) and Transcripts (2 Vols.) forward to Court of Appeals.

Date	Nr.	Proceedings
8/18/89	43	TRANSCRIPT of proceedings before Judge Hughes on Aug. 15, 1989, filed (loose in file)
5-25-90	44	(LNH) INITIAL ORDER ON REMAND, entered Parties ntfd. The parties are to file proposed orders that conform to the opinion of the court of appeals by May 25, 1990. If convenient the court would appreciate receiving a 5-1/4" disk w/the draft order as an ASCII data file or a Word Perfect 5.0 file.
8/24/90	45	Certified Copy of JUDGMENT by Court of Appeals on May 15, 1990 issued as MANDATE on Aug 23, 1990, REMANDING to District Court and VACATING the preliminary injuction, filed.
8/24/90	46	Certified Copy of OPINION by Court of Appeals, filed.
8/24/90		Record on Appeal RETURNED by Court of Appeals, reassembled and sent to crd 10/9/90.
11-6-90	47	(LNH) INJUNCTION ON REMAND., entered Parties ntfd. See Order for Parties, Prior Proceedings, Restraint, Reasons, etc.
11-6-90	48	(LHN) Hearing., filed. Hrg held 11-6-90 Rptr- K Metzger
11-13-90	49	(LNH) ORDER, entered Parties ntfd. By Jan. 1/91 the FDIC shall replead its claims, retaining claim designations A through N, to correspond with the FDIC's original proof of claim, acquired by the FDIC. The FDIC may amend its complaint to include all claims that could have been (a) added through an amended proof of claim or (b) brought as an independent adversary action in the bankruptcy court. SEE CRDER FOR MORE DETAILS.

Date	Nr.	Proceedings
11/26/90	50	Deft. Board of Governors of The Federal Reserve System's MTN TO ALTER OR AMEND JUDGMENT, filed. M/D 12/17/90 by clerk.
11/26/90	51	Deft. The Board of Governors of The Federal Reserve System's MEMORANDUM IN SUPPORT OF ITS MTN TO ALTER OR AMEND JUDGMENT, filed.
11/30/90	52	(LNH) ORDER entered & ptys ntfd. Because the order filed in this case on 11/16/90, Instrument #49) should have been filed in C.A. No. 90-2929, it is struck.
12/12/90	53	Pltfs' RESPONSE TO MOTION OF BOARD OF GOVERNORS TO ALTER OR AMEND JUDGMENT OF THE COURT, filed.
12/27/90	54	(LNH) ORDER entered & ptys ntfd. Since the modified preliminary injunction resolves all issues pending the decision of the U.S. Supreme Court, this case is closed except for enforcement on a mtn of a pty or modification on remand.
12/27/90	55	(LNH) INJUNCTION ON REMAND entered & ptys ntfd. The Court decrees that The Board is enjoined from prosecuting an administrative proceeding against the debtors: (A) For an order to compel the debtors to (1) Transf. propoerty to their present or former subsidiary banks (or successors in interest to, or assigness of, those banks) or (2) Take or refrain from taking any action in respect of the debtors' propoerties; or

Date	Nr.	Proceedings
		(B) Enforce the Board's source of strength doctrine or
		(C) Regulate the day to day financial soundness of the subsidiary banks.
		The Court grants the restraint because a significant threat of irreparable harm to the pltfs exists if the injunction is not granted. (SEE ORDER FOR FURTHER REASONS & DETAILS)
1/28/91	56	Copy of Alan Miller's letter of November 12th to Judge Hughes, filed.

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., and MCORP,
PLAINTIFFS-APPELLEES and

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., and MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

DOCKET ENTRIES

DATE	FILING
Aug. 15, 1989	Appellant's Dup. Notice of Appeal Appellant's Record Excerpts Brief for Appellant Appellant's Motion to Expedite
Aug. 21, 1989	Appellees' Opposition to Motion to Expedite
Aug. 21, 1989	Appellant's Letter to Correct Opening Brief
Aug. 22, 1989	Appellant's Reply to Appellees' Opposition to Motion to Expedite
Aug. 22, 1989	Record on Appeal (6 vols.)
Aug. 22, 1989	Exhibits on Appeal (1 env.)
Aug. 25, 1989	Appellee Creditors Committee's Opposition to Motion to Expedite
Sept. 14, 1989	Brief for Appellee MCorp
Sept. 14, 1989	Brief for Appellee Creditors Committee

DATE	FILING
Sept. 29, 1989	Reply Brief for Appellant
Sept. 29, 1989	Case Assigned for Argument on Nov. 11, 1989
Nov. 11, 1989	Oral Argument
Dec. 20, 1989	Appellees' Rule 28(j) Letter
May 15, 1990	Opinion and Judgment
	* * * * *
June 28, 1990	Appellant's Petition for Rehearing
June 28, 1990	Appellees' Petition for Rehearing, With Suggestion of Rehearing En Banc
July 26, 1990	Appellees Jt. Response to Petition for Rehearing
Aug. 6, 1990	Order Denying Rehearing
Aug. 9, 1990	Appellees' Motion to Stay Mandate
Aug. 17, 1990	Appellant's Response to Motion to Stay Mandate
Aug. 23, 1990	Mandate Issued Record on Appeal and Exhibits Returned to Clerk

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 89-2816

MCORP FINANCIAL, INC., MCORP MGT., AND MCORP,
PLAINTIFFS-APPELLEES AND

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., AND MCORP MGT.,
INTERVENORS-APPELLEES

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
OF THE UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

Appeal from the United States District Court
for the Southern District of Texas

May 15, 1990

Before: GARZA, WILLIAMS and DAVIS, *Circuit Judges.*

W. EUGENE DAVIS, *Circuit Judge*:

The Board of Governors of the Federal Reserve appeals an order of the district court sitting in bankruptcy, enjoining the Board from pursuing its enforcement actions against MCorp without district court approval. 101 B.R. 483. Because the Board's source of strength proceedings exceed its statutory authority, we remand with instructions to enjoin the Board from further prosecution of these charges. Because the district court lacks subject matter jurisdiction to enjoin the Board's actions on the

remaining charges, we vacate the injunction as to these charges.

I.

In October 1988, the Board of Governors of the Federal Reserve (the Board), the primary regulator for bank holding companies, issued a notice of charges and of hearing against MCorp, a Texas-based bank holding company. The Board alleged that MCorp was engaging in unsafe and unsound practices, "likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the subsidiary Banks." A week later the Board issued an Amended Notice of Charges, which sought, among other things, to require MCorp to "implement[ ] an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies." MCorp's subsidiary banks were suffering heavy losses from real estate and energy loans.

In March 1989, three creditors of MCorp commenced an involuntary bankruptcy proceeding against MCorp in the U.S. Bankruptcy Court for the Southern District of New York. The Comptroller of the Currency (OCC), the primary regulator for national banks, subsequently declared a total of twenty of MCorp's subsidiary banks (MBanks) insolvent; OCC appointed the Federal Deposit Insurance Corporation (FDIC) as receiver, divesting MCorp of control of these banks. MCorp was left with five banks. MCorp and two of its subsidiaries, MCorp Financial and MCorp Management then filed voluntary Chapter 11 bankruptcy petitions in the U.S. Bankruptcy Court for the Southern District of Texas. The bankruptcy proceedings against MCorp and its subsidiaries (hereafter collectively referred to as MCorp) were consolidated into one jointly administered proceeding in the Texas forum.

In March 1989, by notice of charges and hearings the Board also commenced further administrative proceedings

against MCorp. The March charges accused MCorp and MCorp Management of violations of § 23A of the Federal Reserve Act, alleging MCorp caused MBank Houston and MBank Preston, two of the closed banks, to provide MCorp Management "unsecured extensions of credit." In late May the Board issued a second amended notice of charges, relating to the October notice of charges, alleging that MCorp had failed to act as a source of financial strength to its remaining subsidiary banks.

MCorp initiated an adversary proceeding against the Board in May 1989, and filed an Emergency Motion for a TRO and preliminary injunction, seeking to enjoin the Board from prosecuting its administrative proceedings against the debtors, and from initiating further administrative proceedings against the debtors without prior approval of the bankruptcy court. The bankruptcy court denied the TRO request. The Board moved the district court to withdraw the reference of the adversary proceeding to the bankruptcy court. The district court granted the Board's motion and placed the case on its own docket.

In June 1989, the district court entered a preliminary injunction granting the relief sought by the debtors. The district court preliminarily enjoined the Board from prosecuting its pending administrative proceedings and

> using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

The district court stated that the preliminary injunction left completely unaffected the Board's "general execution, supervisory and examination duties of the operations of MCorp and its bank subsidiaries and . . . central bank duties as they affect MCorp in common with all other institutions." The court established a procedure for future

Board proceedings, where the Board was first required to present to MCorp any new administrative proceedings, notices of charges or temporary cease and desist orders before their issuance. If the Board and MCorp could not agree whether a proposed proceeding was subject to the preliminary injunction, the Board could then present that issue to the district court. If the court decided the Board's proposed action related to the banks' "operations," the court proposed to exempt this action from the restraint of the preliminary injunction; if however the Board's proposed action affected the reorganization, the district court proposed to stay this action in deference to the bankruptcy court.

The Board appealed the preliminary injunction to this court.

II.

A.

The Board contends first that the district court, sitting in bankruptcy, has no jurisdiction to enjoin the Board's prosecution of its administrative actions, because of 12 U.S.C. § 1818(i) (the Financial Institutions Supervisory Act of 1966 (FISA) as amended), which provides:

> except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

As we stated in *Groos National Bank v. Comptroller of Currency*, 573 F.2d 889 (5th Cir.1978), "section 1818(i) in particular evinces a clear intention that this regulatory process is not to be disturbed by untimely judicial intervention, at least where there is no 'clear departure from statutory authority.'" *Id.* at 895, *quoting Manges v. Camp*, 474 F.2d 97, 99 (5th Cir.1973). Thus, under 12 U.S.C. § 1818(h) and the Administrative Procedure Act (APA), a bank holding company is not ordinarily

entitled to judicial review until the Board issues a final order.

MCorp's principal argument that the district court properly exercised subject matter jurisdiction is predicated on 28 U.S.C. §§ 1334(b) and (d). MCorp argues that these sections of the Bankruptcy Code effectively supersede the Board's exclusive jurisdiction under § 1818(i)(1) to prosecute its enforcement actions, and therefore empower the court to enjoin prosecution of those actions. The district court presumably agreed and concluded that § 1818(i) conflicted with §§ 1334(b) and (d) of the Bankruptcy Code.

Section 1334(b) provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

The plain language of § 1334(b) does not purport to give the district court exclusive jurisdiction over matters arising under Ttitle 11 to the exclusion of administrative agencies; rather, § 1334(b) grants the district court concurrent jurisdiction over matters that otherwise would lie within the exclusive jurisdiction of another court.

The legislative history of § 1334(b) also supports the view that the section was intended to prevent another court from exercising exclusive jurisdiction over a matter brought within the Bankruptcy Code. The Commission on the Bankruptcy Laws of the United States, quoted at length in the House Judiciary Committee report, stated that "[the] first and most important objection to the present dispensation is the division of labor between the bankruptcy court and other courts." H.R. Rep. No. 595, 95th Cong., 1st Sess. 43 (1977), U.S.Code Cong. & Admin.News 1978, pp. 5787, 6005. Under the prior bankruptcy law, the jurisdiction of the bankruptcy

court was limited by the concepts of possession and consent. The House report adopted the reasoning of the Commission that the old law was undesirable because of "the frequent, time-consuming, and expensive litigation of the question whether the bankruptcy court has jurisdiction of a particular proceeding." *Id.* at 45, U.S. Code Cong. & Admin.News 1978, p. 6007. Under the prior jurisdictional scheme, "'when a "summary" proceeding in the bankruptcy court is appropriate and when a plenary suit is required is one of the most involved and controversial questions in the entire field of bankruptcy,'" the Committee observed. *Id.* at 45, U.S.Code Cong. & Admin.News 1978, p. 6007. We are persuaded therefore that it was this division of jurisdiction between bankruptcy courts and *other courts* which the jurisdictional changes of the new law were intended to address.

MCorp argues that the legislative history explains that § 1334(b) grants bankruptcy courts pervasive jurisdiction over all matters and proceedings that arise in or in connection with bankruptcy cases. Yet the legislative history reflects no intent that the bankruptcy court's jurisdiction supersede the exclusive jurisdiction of an administrative agency, or reinvest the courts with jurisdiction barred by § 1818.

In holding that § 1334 superseded § 1818(i), the district court did not harmonize the two statutes, but effectively repealed § 1818(i), and negated its basic sense and purpose of preventing early interference with administrative proceedings. This interpretation invested the district court, sitting in bankruptcy, with equitable power withheld from every other court by the language of § 1818(i). Implied repeals are highly disfavored, one statute will not be considered to impliedly repeal another unless there is a "positive repugnancy" between the two. *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 189-190, 98 S.Ct. 2279, 2299-2300, 57 L.Ed.2d 177 (1978). We find no such irreconcilable conflict here. As the Supreme Court has stated:

> The "plain purpose" of legislation . . . is determined in the first instance with reference to the plain language of the statute itself. Application of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard-fought compromises.

Board of Governors v. Dimension Financial Corp., 474 U.S. 361, 373-74, 106 S.Ct. 681, 688-89, 88 L.Ed.2d (1986) (citation omitted).

MCorp further contends that courts consistently have held that the phrase in § 1334(b), "[notwithstanding] any act of Congress that confers exclusive jurisdiction on [any other] court," was expressly intended to confer on the bankruptcy courts jurisdiction over all matters related to a debtor's Chapter 11 case, including administrative proceedings, citing *In re Casey Corp.*, 46 B.R. 473 (S.D.Ind.1985), and *In re Shelby County Healthcare Services of Ala., Inc.*, 80 B.R. 55 (N.D.Ga.1987). The district court relied in part upon *Casey* in holding that § 1334 superseded the jurisdictional bar of § 1818 (i). These cases are not binding upon this court, however, nor do we find their reasoning persuasive as to the issue before us.

MCorp argues next that the bankruptcy court has exclusive jurisdiction over the Board's enforcement proceeding based on § 1334(d), which provides:

> The district court in which a case under title 11 is commenced or is pending shall have *exclusive* jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate. (emphasis added).

According to MCorp, because the bankruptcy court has exclusive control of MCorp's assets, it necessarily follows from the above section that the Board had no jurisdiction over MCorp. But the Board has not sought control over the property of MCorp's estate in this action, only the opportunity to go forward in its administrative proceedings. Nor at this early stage do we find the Board's enforcement actions to be sham proceedings, brought as a means of controlling the debtor's assets. We therefore do not consider § 1334(d) to grant the district court exclusive jurisdiction here.

MCorp relies on *In re Modern Boats, Inc.*, 775 F.2d 619 (5th Cir.1985), and *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985), to support its argument. *Louisiana Ship Management* and *Modern Boats* both involved in rem proceedings in admiralty where vessels were under seizure. We held that once a chapter 11 petition was filed, the court where that petition was filed enjoyed exclusive jurisdiction over the vessels subject to a maritime lien and that the admiralty court had no jurisdiction over the property. MCorp's reliance on these cases is misplaced because the Board's proceedings do not directly concern the debtor's property.

MCorp also argues that because the above Bankruptcy Code provisions were enacted after § 1818, and do not exempt bank holding company administrative actions from the comprehensive jurisdiction of the bankruptcy court, Congress must have intended no such exemptions. MCorp contends that this is especially true in view of the express exemption granted banks from recourse to bankruptcy protection in § 109 of the Bankruptcy Code. Absent some clear intention to the contrary, however, a specific statute will not be controlled by a general one regardless of the priority of enactment. *Crawford Fitting Co. v. J.T. Gibbons, Inc.*, 482 U.S. 437, 107 S.Ct. 2494, 96 L.Ed.2d 385 (1987). Congress revealed no intent to supersede the specific jurisdictional bar of § 1818

(i) in the legislative history of the Bankruptcy Reform Act, nor the recently enacted Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub.L. No. 101-73, 103 Stat. 183. We decline to imply any affirmative powers to the bankruptcy court from Congress' failure to act in this area.

In analogous circumstances, several circuits have held that the automatic stay provisions of the Bankruptcy Code in the case of a bankrupt employer do not supersede the anti-injunction provision of the Norris-LaGuardia Act, which precludes courts from enjoining union conduct. In *In Re Crowe & Associates, Inc.*, 713 F.2d 211, 214-16 (6th Cir.1983), the Sixth Circuit concluded that the legislative history of the Bankruptcy Reform Act was silent as to the anti-injunction provisions of the Norris-LaGuardia Act, and this silence was "self-evident proof that Congress never intended to supersede or transcend [the Norris-LaGuardia Act], since we cannot believe that the Norris-LaGuardia Act was to be superseded *sub silentio.*" *Id.* at 215, *quoting In re Petrusch*, 667 F.2d 297, 300 (2d Cir.1981); *see also Briggs Transportation Co. v. International Brotherhood of Teamsters*, 739 F.2d 341, 343 (8th Cir.1984) ("the parties have cited us to nothing in the Bankruptcy Code or its legislative history indicating a congressional intent to lift the jurisdictional restrictions of the Norris-LaGuardia Act").

The Board also relies on *Becker's Motor Transportation, Inc. v. Needham's Motor Service, Inc.*, 632 F.2d 242 (3d Cir.1980), *cert. denied*, 450 U.S. 916, 101 S.Ct. 1358, 67 L.Ed.2d 341 (1981), in which the court held independent statutory provisions barring any suit to restrain the assessment or collection of taxes deprived the bankruptcy court of the authority to enter an injunction against the government's tax collection efforts. In reaching this conclusion the Third Circuit in *Becker's Motor* distinguished *Bostwick v. United States*, 521 F.2d 741 (8th Cir.1975), a tax injunction case relied upon by MCorp and the lower court in which the Eighth Circuit reached the contrary

result. The court in *Becker's Motor* concluded that the *Bostwick* court created a judicial exception to the tax anti-injunction statute in contravention of clear congressional intent. *Becker's Motor*, 632 F.2d at 246. We agree with the Third Circuit that absent clear congressional intent any argument for permitting the bankrupcty court's jurisdiction to supersede existing anti-injunction legislation should be addressed to Congress, and we will not imply the repeal of such legislation.

For the above reasons, we conclude that the plain language of § 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings if the Board's actions do not exceed the authority Congress granted to it. We turn next to MCorp's argument that the Board is exceeding its statutory authority.

B.

MCorp asserts that the Board lacks authority to proceed against banks in FDIC receivership, that the Board's self-dealing charges are a pretext for avoiding the exclusive jurisdiction of the bankruptcy court over MCorp's assets, and that the Board's source of strength policy is without statutory authority.

In *Manges v. Camp*, 474 F.2d 97 (5th Cir.1973), we recognized that the statute at issue here, § 1818, that withdraws the jurisdiction of the court in deference to an agency, is not effective when the agency exeeds its authority under that statute. There is "a very strong court created exception to withdrawal statutes. This exception comes into play when there has been a clear departure from statutory authority, and thereby exposes the offending agency to review of administrative action otherwise made unreviewable by statute." *Manges*, 474 F.2d at 99. If the Board's proceedings exceed its statutory authority, we may review the Board's action prior to a final order despite the jurisdictional bar of § 1818; if the Board "was not acting within [the] authority granted by Congress,

then 12 U.S.C. § 1818(i) could not withdraw jurisdiction." *Manges*, 474 F.2d at 99.

The Supreme Court established this exception in *Leedom v. Kyne*, 358 U.S. 184, 79 S.Ct. 180, 3 L.Ed.2d 210 (1958). In *Leedom* the Court found district court review proper, despite an express preclusion provision, where the National Labor Relations Board had acted in excess of its delegated powers.

The Court stated in *Leedom* that "[t]his suit is not one to 'review,' in the sense of that term as used in the [National Labor Relations] Act, a decision of the [National Labor Relations] Board made within its jurisdiction. Rather it is one to strike down an order of the Board made in excess of its delegated powers. . . ." *Leedom*, 358 U.S. at 188, 79 S.Ct. at 183. The D.C. Circuit recently characterized the *Leedom* rule as one permitting a court in the face of a withdrawal statute to determine "whether an agency has acted 'in excess of its delegated powers' " and "whether the agency action 'on its face' violated a statute." *Dart v. United States*, 848 F.2d 217, 222 (D.C. Cir.1988). *See Coit Independence Joint Venture v. Federal Sav. & Loan Ins. Corp.*, —— U.S. ——, 109 S.Ct. 1361, 103 L.Ed.2d 602 (1989); *Breen v. Selective Service Local Board*, 396 U.S. 460, 90 S.Ct. 661, 24L.Ed.2d 653 (1970); *Oestereich v. Selective Service System Local Board*, 393 U.S. 233, 89 S.Ct. 414, 21 L.Ed.2d 402 (1968). *Cf. Bowen v. Michigan Academy of Family Physicians*, 476 U.S. 667, 680 n. 11, 106 S.Ct. 2133, 2141 n. 11, 90 L.Ed.2d 623 (1986).

MCorp argues that the Board exceeded its authority in three respects because it has no authority to (1) regulate MCorp's relationships with *former* MBanks, now under FDIC receivership, which are the subject of the administrative proceedings; (2) assist the FDIC, as receiver of the closed MBanks, to obtain damages under the pretext of punishing MCorp for violations of § 23A of the Federal

Reserve Act[1] which concerns self-dealing among holding company subsidiaries; and (3) compel a bank holding company to transfer its funds to subsidiary banks.

MCorp argues first that the Board lacks authority to regulate MCorp's relationships with former subsidiary banks now under FDIC receivership. Both the "source of strength" charges and the self dealing charges, as initially set out by the Board, were levelled in part to the relationship between MCorp and MBanks which were later closed and placed under FDIC receivership. We are persuaded that the Board is at least entitled to make a determination on the legitimacy of the credit transaction with the closed banks at issue to allow it to evaluate what remedy it wants to pursue against MCorp. Certainly the Board's attempt to do that is not facially invalid.

MCorp next argues that the Board's § 23A proceeding is simply an attempt to assist the FDIC to obtain MCorp's property under the guise of remedying a violation of § 23A of the Reserve Act. We disagree. The Board is well within its authority in seeking an order against MCorp to cease and desist any transactions which violate the provisions of § 23A, or "to take affirmative action" as may be appropriate. 12 U.S.C. § 1818(b)(1). The notice of charges relating to the appropriateness of the credit transactions between an MCorp nonbank subsidiary and two of MCorp's former subsidiary banks is not on its face a sham proceeding initiated only to assist the FDIC to collect damages; at least a fact issue is presented on the merits of the § 23A charges. The

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[1] Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, prohibits a bank from extending credit to a nonbank affiliate unless the extension of credit is secured by collateral having a market value of at least 100 percent of the loan. The Board has charged that MCorp violated this requirement by causing two of its former subsidiary banks to extend $63.7 million of unsecured credit to an affiliated subsidiary of MCorp, and failing to make timely repayments to the subsidiary banks that extended the credit.

mere prosecution of the charges before the Board does not in itself disturb the bankruptcy court's alleged exclusive jurisdiction over MCorp's property under § 1334(d).

We are persuaded, however, that a serious legal issue is presented as to whether the Board has statutory authority to pursue its source of strength charges. Before turning to that problem, we address a threshold argument of the Board that we are precluded from considering the Board's authority to proceed.

The Board contends that MCorp may not judicially challenge at this stage the Board's authority to proceed with its charges because MCorp has not exhausted its administrative remedies. The Board relies on *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 58 S.Ct. 459, 82 L.Ed. 638 (1938), in which the Court stated that "[j]udicial relief is not normally available for supposed or threatened injury until the prescribed administrative remedy has been exhausted." *Id.* at 50, 58 S.Ct. at 463.

Myers did not present a challenge to the agency's authority to act on the complaint presented to it. The petitioning employer factually challenged the interstate nature of the employer's business, one of the elements of the NLRB's charge. The Court concluded that this factual determination should be made by the NLRB. The Supreme Court held that a federal district court is without jurisdiction to enjoin the NLRB from "hearing and determining what Congress declared the [National Labor Relations] Board should hear and determine in the first instance." *Id.* at 50-51, 58 S.Ct. at 463-464 (footnote omitted).

The question of the Board's authority to impose its source of strength requirement is quite a different issue. No facts are in dispute. The sole question presented is a legal one: whether the Board has authority to order a holding company to transfer its funds to its troubled subsidiary banks. The Board has instituted proceedings

to require that holding company to transfer those funds. The legal issue of the Board's authority can be resolved without further factual development. "[P]rompt resolution will eliminate uncertainty and be in the interest of efficient judicial administration." *Indep. Bankers Ass'n v. Heimann*, 613 F.2d 1164, 1167 (D.C.Cir.1979), *cert. denier*, 449 U.S. 823, 101 S.Ct. 84, 66 L.Ed.2d 26 (1980). Because we conclude that MCorp is not required to exhaust its administrative remedies in this circumstance, we turn to the merits of whether the Board has authority to require the holding company to transfer its funds to troubled subsidiary banks.

The Board contends it has authority to issue the source of strength charges under §§ 1818(b)(1) and (3), which empower it to file charges against a bank holding company which the Board believes (1) has violated or is about to violate a "law, rule or regulation"; or (2) is engaging in an "unsafe or unsound" practice.[2] The Board

[2] Termination of status as insured depository institution, Section 1818 which is captioned in § (b)(1) and (3):

(b) Cease-and-desist proceedings

(1) If, in the opinion of the appropriate Federal banking agency, any insured depository institution . . . is engaged or has engaged, or the agency has reasonable cause to believe that the depository institution . . . is about to engage, in an unsafe or unsound practice in conducting the business of such depository institution, or is violating or has violated, or the agency has reasonable cause to believe that the depository institution or any institution-affiliated party is about to violate, a law, rule, or regulation . . . the agency may issue and serve upon the depository institution or such party a notice of charges in respect thereof . . .

(3) This subsection . . . shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956. . . . Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency, other than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-

contends that MCorp has failed to act as a source of strength for its bank subsidiaries in violation of the Board's regulations and policy statement. The Board also contends that this failure constitutes an unsafe or unsound practice in violation of § 1818.[3]

We consider first whether the authority the Board assumed under its regulation and policy statement exceeds its statutory grant. The Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. § 1841 et seq., grants the Board supervisory control over the formation, structure and operation of bank holding companies and their nonbank subsidiaries. Section 3(a) of the Act, 12 U.S.C. § 1842(a), provides that no company may acquire control of a bank without prior approval by the Board. In determining whether to approve an application, § 3(c) of the Act, 12 U.S.C. § 1842(c), directs the Board to consider "the financial and managerial resources and future prospects of the company or companies and the banks concerned." [4]

and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank).

12 U.S.C. §§ 1818(b)(1) and (3), *amended by* FIRREA, Pub. L. No. 101-73, §§ 901(d), 902(a)(1)(A).

[3] Because we conclude that the source of strength proceedings exceed the Board's statutory authority, we need not resolve whether the source of strength charges relating to MCorp's former subsidiary banks are beyond the Board's authority.

[4] Section 1842 states in relevant part:

Acquisition of bank shares or assets

* * *

c) Factors governing determination of application for approval . . .

In every case, the Board shall take into consideration the financial and mangerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

In 1984, as part of its comprehensive revision of Regulation Y, the Board added 12 C.F.R. § 225.4(a)(1), which provides:

> § 225.4 Corporate Practices
>
> (a) *Bank holding company policy and operations.*
>
> (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not contuct [*sic*] its operations in and unsafe or unsound manner.

Revision of Regulation Y, 49 Fed.Reg. 820 (1984) (codified at 12 C.F.R. § 225.4(a)(1)).

In April 1987, the Board published a policy statement in the Federal Register, which further provided:

> It is the policy of the Board that in serving as a source of strength to its subsidiary banks, *a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks* during periods of financial stress or adversity and should maintain the financial ffexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. . . . A bank holding company's failure to meet its obligation to serve as a source of strength to its subsidiary bank(s), including an unwillingness to provide appropriate assistance to a troubled or failing bank, will generally be considered an unsafe and unsound banking practice or a violation of Regulation Y, or both. . . . .

Policy Statement, 52 Fed.Reg. 15707, 15708 (1987) (emphasis added). This policy statement was effective April 24, 1987. The Board solicited comments on the policy, with a view to revising the statement in light of such comments. No subsequent revision has been published.

The Board also relies on the broad language of § 5(b) of the BHCA, 12 U.S.C. § 1844(b), for authority to issue

the above regulation and policy statement. Section 5(b) states:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof.

The Board finds support for its authority to enforce its source of strength requirements in *Board of Governors v. First Lincolnwood Corp.*, 439 U.S. 234, 99 S.Ct. 505, 58 L.Ed.2d 484 (1978). In this case the Court considered whether the BHCA authorized the Board to disapprove an application of a proposed bank holding company solely on grounds of financial unsoundness, and in the absence of any anticompetitive effects resulting from the transaction. The Supreme Court answered this question in the affirmative and upheld the Board's rejection of a proposed holding company's application. This holding was based on the statutory language of 12 U.S.C. § 1842(c), as well as the legislative history of the BHCA. The Supreme Court stated:

> The language of the statute supports the Board's interpretation of § 3(c) as an authorization to deny applications on grounds of financial and managerial unsoundness even in the absence of any anticompetitive impact. Section 3(c) directs the Board to consider the financial and managerial resources and future prospects of the applicants and banks concerned "[i]n every case," not just in cases in which the Board finds that the transaction will have an anticompetitive effect.

Id. at 243, 99 S.Ct. at 510.

In response to the court of appeals' holding that the Board's authority to deny an application because of unsound financial or managerial consideration was limited to instances in which the unsoundness was caused or exacerbated by the proposed transaction, the Court stated:

> Indeed, the Court of Appeals' construction of the statute would require the Board to approve formation of a bank holding company with corrupt management simply because management would become no more corrupt by virtue of the transaction. We hesitate to adopt a construction that would yield such an anomalous result.

Id. at 250, 99 S.Ct at 514.

Finally, addressing the arguments of the dissent, the Court stated that its holding was not intended to extend the Board's authority to day-to-day supervision of banks, but allowed the Board to disapprove an application to prevent the formation of an unsound holding company.

> In the dissent's view, the Board, by looking beyond the transaction before it, attempted to exercise the day-to-day regulatory authority over banks which Congress denied to it and conferred on the Comptroller. We disagree with the basic premise of the dissent's argument. As the Board found, the *effect* of this transaction would have been the formation of a financially unsound bank holding company. Thus, the Board's attempt to prevent this effect and to induce respondent to form an enterprise that met the Board's standards of financial soundness was entirely consistent with the language the dissent cites.

Id. at 252 n. 18, 99 S.Ct. at 515 n. 18 (emphasis added). In *First Lincolnwood*, therefore, the Court relied upon the express provisions of § 3(c) that required the Board to consider financial soundness of the subsidiary bank in determining whether to approve a holding company's application. The Court made it clear that it did not read the BHCA to grant the Board authority to regulate the day-to-day financial soundness of the subsidiary banks.

The Supreme Court in *Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361, 106 S.Ct. 681, 88

L.Ed.2d 691 (1986), considered whether the Board exceeded its authority in expanding certain definitions in Regulation Y. The Board, as part of Regulation Y, included institutions that were not banks within the Board's regulatory ambit. The Court concluded that the Board had exceeded its authority in attempting to regulate the "nonbank banks."

The Court found that the BHCA "vests broad regulatory authority in the Board over bank holding companies 'to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit.'" *Id.* at 365, 106 S.Ct. at 684, *quoting* S.Rep. No. 91-1084 (1970), U.S. Code Cong. & Admin.News 1970, p. 5541. The Board's new definitions did not fall within the plain purposes of the BHCA, the Court concluded. The Court added that "§ 5 only permits the Board to police within the boundaries of the Act. . . ." *Id.* at 373 n. 6, 106 S.Ct. at 688 n. 6.

First Lincolnwood and *Dimension Financial* together teach that the primary purposes of the BHCA are to prevent the concentration of control of banking resources, and to separate banking from non-banking enterprises. *First Lincolnwood* is narrowly written and expressly limits the Board's authority to consider financial and managerial soundness of subsidiary banks to the Board's decision to grant or deny a holding company's application. Section 3(c) of the BHCA specifically grants this authority to the Board. The BHCA does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application, and *First Lincolnwood* finds this regulatory authority lacking in the day-to-day operations of a subsidiary bank. For these reasons, we conclude that the Board is without authority under the BHCA to require MBank to transfer its funds to its troubled subsidiary bank.[5]

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[5] As a condition to approving an application, the Board could possibly require the holding company to agree to maintain the sub-

The Board asserts as an independent basis for its source of strength regulation, policy statement and enforcement proceedings its broad authority under § 1818 (b)(1) and (3) of FISA to order a holding company to cease and desist from any activity that, in the Board's judgment, constitutes an unsafe or unsound practice. The Board argues that MCorp's failure to provide capital to its subsidiary banks is an unsafe or unsound practice which the Board may act to restrain under § 1818.

In determining whether we should accept the Board's interpretation of a statute the Board is charged with enforcing, we look to the test established by the Supreme Court in *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984).

> If Congress has spoken clearly to the issue presented in a case, that intent controls. 467 U.S. at 844 [104 S.Ct. at 2782]. If the agency's interpretation is contrary to the clear intent of Congress, the agency's interpretation is invalid. If, on the other hand, Congress has no clear intent as to the particular question at issue, the courts may invalidate the agency's interpretation only if it is "unreasonable" or "impermissible." *Id.*

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sidiary banks to some degree of financial soundness. The Federal Home Loan Bank Board (FHLBB) has long followed this practice in approving savings and loan holding company applications; in 1981, we approved the practice in *Kaneb Services, Inc. v. Federal Sav. & Loan Ins. Corp.*, 650 F.2d 78 (5th Cir. 1981). The statutory authority of the FHLBB to regulate savings and loan holding companies is practically identical to the authority granted the Board to regulate bank holding companies. *See* 12 U.S.C. §§ 1730(e)(1) and (3), 1730a(e)(2); Regulatory Capital Maintenance Obligations of Acquirers of Insured Institutions, 53 Fed.Reg. 31761 (1988); Acquisition of Control of Insured Institutions, 54 Fed.Reg. 32959 (1989) (to be codified at 12 C.F.R. § 574.7(a)(1) and (3)). The Office of Thrift Supervision, the successor to the FHLBB as primary regulator of savings and loan holding companies after FIRREA, continues this practice in its current regulations. *See* Transfer and Recodification of Regulations Pursuant to Financial Institutions Reform, Recovery and Enforcement Act, 54 Fed.Reg. 49411 (1989).

Investment Co. Institute v. Federal Deposit Ins. Corp., 815 F.2d 1540, 1546 (D.C.Cir.), *cert. denied*, 484 U.S. 847, 108 S.Ct. 143, 98 L.Ed.2d 99 (1987). *See also American Insurance Assoc. v. Clarke*, 865 F.2d 278, 280-81 (D.C.Cir.1988).

The Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies. As we stated in *Groos Nat'l Bank v. Comptroller of Currency*, 573 F.2d 889, 897 (5th Cir. 1978), "[t]he phrase 'unsafe or unsound banking practice' is widely used in the regulatory statutes and in case law, and one of the purposes of the banking acts is clearly to commit the progressive definition and eradication of such practices to the expertise of the appropriate regulatory agencies." Thus, under the *Chevron* analysis, in the absence of clear congressional intent on the meaning of this language, we must examine the "reasonableness" and "permissibility" of the Board's interpretation that the failure of the holding company to inject capital into subsidiary banks is an "unsafe or unsound" practice.

In *Gulf Federal Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259 (5th Cir.1981), *cert. denied*, 458 U.S. 1121, 102 S.Ct. 3509, 73 L.Ed.2d 1383 (1982), the Federal Home Loan Bank Board found that Gulf Federal's contracting practice was an "unsafe or unsound" pracice within the meaning of § 1818. We disagreed and concluded that the FHLBB's finding that Gulf Federal's use of inconsistent contract terms was an unsafe or unsound practice was not a reasonable interpretation of the "unsafe or unsound practice" provision.

We also noted in *Gulf Federal* that the "unsafe or unsound practice" provision was the subject of lively congressional debate at the time the statute was enacted. We

observed that the authoritative definition of an unsafe or unsound practice, adopted in both Houses, was that:

> Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

Id. at 264, *quoting* 112 Cong.Rec. 26474 (1966). *See* 112 Cong.Rec. 24984, 26474 (1966).

Enforcement of the Board's source of strength regulation requiring MCorp to transfer MCorp's funds to the troubled subsidiary banks can hardly be considered a "generally accepted standard[] of prudent operation." Such a transfer of funds would require MCorp to disregard its own corporation's separate status; it would amount to a wasting of the holding company's assets in violation of its duty to its shareholders. Also, one of the fundamental purposes of the BHCA is to separate banking from commercial enterprises. That purpose is obviously not served as merely an extension of its subsidiary bank.

Congress first under the BHCA in 1956 and later in amendments to the Federal Reserve Act in 1966 has generally defined with specificity the dealings between subsidiary banks and nonbank affiliates, including holding companies, it considered unsafe and unsound. *See* Bank Holding Company Act of 1956, c. 240, § 6, 70 Stat. 137, *repealed by* Pub.L. No. 89-485, § 9, 80 Stat. 240 (1966); Pub.L. No. 89-485, § 12(a) (amending 12 U.S.C. § 371c). *See also* S.Rep. No. 1179, 89th Cong., 2d Sess., *reprinted in* 1966 U.S.Code cong. & Admin.News 2394-96. Congress made no effort in any of this legislation to require holding companies to make capital injections into subsidiary banks as part of these safeguards. Congress noted only that the provision enacted

as part of the BHCA "does not prohibit the borrowing of funds by any subsidiary in the system from the parent bank holding company." S.Rep. No. 1095, 84th Cong., 1st Sess., *reprinted in* 1956 U.S.Code Cong. & Admin.News 2482, 2496. In sum, Congress set forth detailed limits on transactions considered unsound between subsidiary banks and holding companies, without mentioning the infusion of capital by holding companies into subsidiaries. This strongly supports MCorp's argument that Congress never intended to grant authority to the Board to require a holding company to inject capital into subsidiary banks as a safeguard against "unsafe or unsound" practices.

This is consistent with the conclusion reached by the Shadow Financial Regulatory Committee,[6] responding to the Board's source of strength policy. The Committee stated that, "while Congress has empowered regulators of banks to issue capital directives to institutions in their charge, it has not authorized the Fed to issue capital directives to bank holding companies." 48 Banking Rep. (BNA) No. 21, at 923 (May 25, 1987).

Thus, we conclude that the Board's determination that the holding company's failure to transfer its assets to a troubled subsidiary was an "unsafe or unsound practice" under §§ 1818(b)(1) and (3) is an unreasonable and impermissible interpretation of that term.

It is not our role to pass judgment on the wisdom of the scheme Congress put in place to regulate bank holding companies. Similarly, the Board cannot exceed the authority Congress granted to it to correct perceived flaws in the congressional scheme. As the Supreme Court stated in *Dimension Financial:*

> The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the stat-

[6] Formed in February 1986, the Shadow Financial Regulatory Committee (SFRC) meets periodically to monitor regulation of the financial services industry. The SFRC is composed of economists, academics and former financial regulators.

ute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute.

If the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the Courts, to address.

474 U.S. at 374, 106 S.Ct. at 688-689 (footnote omitted).[7]

III.

Because we find that the Board's source of strength proceedings exceed its statutory authority, we remand this case to the district court with instructions to enjoin the Board from further prosecution of this charge. The remaining preliminary injunction entered by the district court is vacated because it lacked subject matter jurisdiction to interfere with the Board's § 23A proceedings.

REVERSED, VACATED and REMANDED.

[7] The Board also asserts on appeal that its administrative proceedings are exempt from both the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362(b) and the general equitable power of the bankruptcy court under § 105 of the Code. Because we find that the district court, sitting in bankruptcy, lacks jurisdiction over the Board's ongoing enforcement actions, we need not address MCorp's argument that the Bankruptcy Code's stay provisions prevent the Board from proceeding.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civ. A. No. 89-1677
Bankruptcy No. 89-02312-H3-11
Adv. No. 89-0298

IN RE MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS

MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS, AND OFFICIAL CREDITORS' COMMITTEE, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 19, 1989]

OPINION ON THE PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM

HUGHES, *District Judge.*

1. *Introduction.*

As debtor in possession, a bank holding company and two of its nonbank subsidiaries (MCorp, MCorp Financial, Inc., and MCorp Management [Debtor]) applied for

a preliminary injunction against the Board of Governors of the Federal Reserve System (Board). The Debtor seeks to enjoin the Board from prosecuting administrative proceedings against the holding company and its nonbank subsidiaries as part of the Board's regulation of the safety and integrity of the bank subsidiaries. The issue is whether a nonbank corporation that owns banks and nonbanks as subsidiaries is entitled to have its bankruptcy case principally directed by the banking agencies or by the bankruptcy process. An injunction will be issued to allow possible reorganization of the Debtor through the bankruptcy court.

2. *Statutes.*

The Debtor asserts:

A. This court sitting in bankruptcy has exclusive jurisdiction over all the property in the debtor's estate. 28 U.S.C. § 1334(d);

B. The Board's actions are in reality an attempt to control the assets of the estate in violation of the automatic stay. 11 U.S.C. § 362(a).

C. If the Board is exempt from the automatic stay, the bankruptcy code authorizes an injunction to protect the debtor from third-party interference. 11 U.S.C. § 105.

The Board counters:

A. The Financial Institutions Supervisory Act (FISA) withdraws jurisdiction from the courts, superseding the automatic stay imposed by the bankruptcy code. 12 U.S.C. § 1818(i).

B. The Board's proceedings are regulatory actions exempted from the automatic stay. 12 U.S.C. § 1818(b); 11 U.S.C. § 362(b).

C. The character of the regulation and the general scheme of banking supervision are not the third-party acts that should be subject to an injunction against interference with a bankruptcy case.

3. *Background of the Controversy.*

At the beginning of 1989, MCorp was a bank holding company, owning twenty-five bank subsidiaries and several nonbank subsidiaries. In common with many financial institutions, MCorp has suffered large, continuing losses from its real estate loans, having already written down its bad oil-related loans. In March, the comptroller of the currency declared twenty of MCorp's banks insolvent and closed them. The banks continued to operate as nationalized receiverships through the Federal Deposit Insurance Corporation under the name Deposit Insurance Bridge Bank.

This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp, and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp and it was transferred here to pend under Case Number 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

The filing in New York of the involuntary case precipitated the bank closing by the comptroller and the voluntary cases by the subsidiaries. The Official Creditors' Committee of the debtors was allowed to intervene to assert essentially the same grounds as MCorp in support of an injunction.

MCorp is left with five bank subsidiaries and all of its nonbank subsidiaries, two of which are also debtors in bankruptcy. MCorp maintains that twelve of its banks were closed illegally or improvidently. The closed institutions are not under the control of MCorp because they are under FDIC receiverships.

The Federal Reserve Board has initiated administrative actions against MCorp as a bank holding company for violating its regulations that ensure the integrity of the banking system through the requirement that the holding company be a "source of financial strength" to the subsidiary banks. The administrative actions will conflict with MCorp's ability to address a global reorganization in the bankruptcy case.

4. *Standard for Injunctive Relief.*

This proceeding is in the nature of a preliminary declaratory judgment rather than a normal preliminary injunction which maintains some status between principal litigants until the merits of their claims have been heard. This injunction will prospectively assign one authority or another to supervise a restructuring.

Despite the peculiar nature, this injunction meets the regular requirements. *Canal Auth. v. Callaway*, 489 F.2d 567, 572 (5th Cir.1974).

A. MCorp is likely to prevail on the merits of its legal priority claim. The automatic stay is applied rigorously, and only in exceptional cases is there a departure from protecting the debtor. Where the regulation is inextricably mixed with the restructuring process rather than some ancillary public health or safety question, MCorp ought to succeed with its claim of insulation from the Board by the automatic stay. Even if the regulatory exemption applies, the highly probable result is MCorp's success because of the availability of the anti-interference protection.

B. Enjoining the Board is necessary to prevent imminent and irreparable harm to the Debtor; responding to the Board's proceedings deprives MCorp of resources desperately needed to prepare for its reorganization. If MCorp is to survive, to the benefit of the creditors and the government, it must act quickly, for a lingering Chapter 11 case inevitably becomes a liquidation. Obliging MCorp to respond in multiple forums to multiple agencies, each with its own internal and external priorities, would dissolve the focus MCorp needs to see the route to survival.

C. The risk to MCorp in both probability and magnitude exceeds the possible danger to the Board's interests. The safeguards of the bankruptcy code ensure the protection of the generalized interest of the Board in healthy holding companies. The Board's exposure to liability independent of its regulatory concern is minimal, and it is not jeopardized by this injunction. Its interest can adequately be represented in the bankrupcy proceedings.

D. The issuance of this injunction does not harm the public interest defined either as the general public interest or as the discernible interests of unrepresented third-parties. To the contrary, the public is served by having all proceedings in one forum, especially a forum where the individuals in the affected public can participate.

5. *Issue.*

When a bank holding company seeks reorganization under the bankruptcy code, does the general bankruptcy process supersede the processes of the agencies that regulate banking?

6. *Regulatory Framework.*

A. *Comptroller of the Currency.*

General supervision of national banks, including their creation and closing, is confided to the comptroller of the currency. If, on his examination, the comptroller determines that a bank is insolvent, he places it in receivership. That receiver is the FDIC. 12 U.S.C. § 191.

B. *Federal Deposit Insurance Corporation.*

The FDIC has two roles in banking regulation. First, it acts as a limited insurer of deposits to attract depositors to the banking system and to prevent runs, with their destructive effects. Second, the FDIC acts as a receiver for the estate of a bank that has been closed by the comptroller. 12 U.S.C. § 1811.

C. *Federal Reserve Board.*

The Federal Feserve System is the central bank for the United States, and among its powers are responsibilities for the regulation of banks and bank holding companies. The Board's regulation takes many forms, like its clearinghouse function, furnishing liquidity, margin and capital requirements, open market purchases and sales, and currency issuance.

Under the FISA, if the Board finds that a bank holding company has engaged in an unsafe or unsound practice, the Board has the authority to notify the company of its charges, stating the violations and setting a hearing before the Board. 12 U.S.C. § 1818(b). If the charges are proved, the Board can order the company to stop the derelict practices and to take affirmative steps to prevent future violations.

Temporary orders to desist may also be issued by the Board before proceedings are completed.

These orders may be issued without a hearing and are effective immediately.

Because the purpose of vesting the Board with these powers is to assure the soundness of banks that are owned by holding companies, transactions between the parent company and its nonbank subsidiaries may be regulated to prevent losses to the bank subsidiaries.

7. *Classes of Regulation by the Board.*

The Board has claimed four classes of authority over the Debtor and its components. First, the Board is empowered to regulate the banking process, through its clearinghouse function, for example.

Second, the most obvious class of power that the Board has over banks is through its central bank functions. These directly affect the parties here, through reserve and margin requirements for instance, but they are fashioned at a higher level than individual bank operation. These are not involved; the bank subsidiaries of MCorp will continue to abide by the Board's general regulation of banking transactions.

Third, the Board is charged generally with supervision of bank and bank holding company practices that may endanger the integrity of the banks and the system of banks. These vaguely defined powers cover items from the requirement of minimum capital to the prohibition of self-dealing.

Fourth, the Board asserts the authority to direct the activities of the holding company's nonbank subsidiaries in their transactions unrelated to banks or banking including forcing a sale for capital infusion.

8. *Priority of Regulation.*

Banks cannot file for bankruptcy; they must reorganize or liquidate under the banking laws. Bank holding companies, however, are not prohibited from recourse to bankruptcy, and while they are regulated by banking

agencies, they cannot be reorganized or liquidated under the laws for banks. Congress has amended both the banking and the bankruptcy laws several times, never resolving this potential conflict.

The new bankruptcy code was adopted in 1978, long after bank holding companies had been regulated. The holding company act has been frequently amended itself. The dual nature of bank holding companies implicates the interests of the systems both of regulation and of reorganization. The statutes as enacted limit the bank regulators to primacy in dealing with banks.

When a bank holding company is a debtor in possession, the conflict between the court's restructuring of the corporation and the Board's regulating can be resolved by allowing the Board to participate in the court proceeding. Preclusion by the bankruptcy forum would not cover the Board's clearinghouse or monetary functions, but it would restrict the Board's supervision of MCorp's asset allocation, intra-group transactions, and third-party contracts. This would give the Debtor the reprieve needed to retrieve its vitality.

Allowing the Board's proceedings to continue in a separate forum poses several problems. Parrallel proceedings are both confusing and inefficient. The potential for a successful reorganization would be jeopardized. The bankruptcy code is designed to be a comprehensive plan to rehabilitate the debtor to the exclusion of actions impairing reorganization.

Without minimizing the importance of the Board's administrative power over bank holding companies, the need for the court's power over the entirety of the debtor's estate takes precedence. This preemption is supported by policy and law.

Financial Institutions Supervisory Act, 12 U.S.C. § 1818(i), says:

> [N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, supend, terminate, or set aside any such notice or order.

Similar jurisdictional limitations have been overridden through control of the debtor's estate having been entrusted to the authority of the bankruptcy court. This construction has been employed in cases affecting the Court of Claims and the Tax Court (both administrative rather than judicial); their jurisdictional grants are parallel to the Board's and distinct from the judicial power through the bankruptcy code. *See re Casey Corp.*, 46 B.R. 473 (Bankr.S.D.Ind.1985); *Bostwick v. United States*, 521 F.2d 741 (8th Cir. 1975).

The *in rem* proceedings in admiralty, which are particular liquidation actions, yield to the bankruptcy code's plan for general liquidation. This is true even though maritime jurisdiction is directly a judicial power of international significance. *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir.1985). The grant of jurisdiction over the debtor's estate for the restricted purpose of facilitating the reorganization of the debtor supersedes other jurisdictional limits. 28 U.S.C. § 1334(d).

9. *Regulatory Exception to the Stay.*

Even if the principal power over the debtor's estate is in the bankruptcy court, agencies whose mandate includes matters of "police or regulatory power" are not barred by the filing of a petition from pursuing the debtor. 11 U.S.C. § 362(b)(4). Although very few imaginable acts of a governmental unit could not plausibly be claimed to be within that category, congress did not act to exempt all governmental actions from the automatic stay, for the phrase "police and regulatory power" is a peculiar way to say "all."

A. There are two tests usually articulated in deciding whether the stay applies to a governmental action. Although neither of these dichotomies is particu-

larly applicable with precision, they both do recognize that there are automatically stayed government activities.

(1) The first divides governmental actions into two categories: pecuniary interest of the state in the debtor's estate or public policy affecting safety and health.

(2) The second divides governmental actions into two slightly different categories: those that adjudicate private rights and those that effectuate public policy. *See N.L.R.B. v. Edward Cooper Painting, Inc.*, 804 F.2d 934, 942 (6th Cir. 1986).

B. A solution to the definitional problem can be reached on procedural grounds. The principal difference between the automatic stay and the anti-interference injunction is the burden on the participants. For ordinary acts against the debtor's property, the stay has minimal risk to those who are blocked or the public. Because the automatic stay of private acts against the debtor's estate covers the majority of the debtor's relations, it has enough relief to allow reorganization. For governmental acts (as well as third-parties) to be blocked, however, the debtor must identify and move against them specifically through an injunction. The effect of this reading would produce a clear and reasonable approach, but it would still be an alteration of the plain text of the statute.

C. One solution to the lack of precision in the clause that allows some escape by governments from the stay is to attempt to classify governmental actions between those that are of immediate, actual concern to the health of the general public and those that are assists to private parties, asset allocations, and property acquisitions for its own account, as they are at cross purposes with the federal reorganization powers.

The Board's interest in protecting the public from "unsafe" banking practices may be important, but it does not rise to the level of injury or immediacy of aircraft certification, adulterated foods, or transportation of diseased livestock. 12 CFR 225, Reg. Y. In a case involving the Environmental Protection Agency, a court of appeals has said that the scope of the exemption from the stay is not limited to matters of imminent physical peril; however, the case dealt with a landfill without several safeguards, including a prevention of polluted runoff, so the comment was an observation, not a holding. *Matter Commonwealth Oil Refining Co., Inc.*, 805 F.2d 1175 (5th Cir.1986) *cert. denied sub nom. Commonwealth Oil and Refining Co. v. E.P.A.*, 483 U.S. 1005, 107 S.Ct. 3228, 97 L.Ed.2d 734 (1987). Notably, the legislative history of the code reveals that bankruptcy courts have been enforcing the automatic stay against state pollution abatement efforts. *See* HR Rep. No. 95-595, 95th Cong., 1st Sess., 174-5 (Bankruptcy Reform Act of 1978), U.S. Code Cong. & Admin. News 1978, pp. 5787, 6134, 6135.

One court has held that access to assets that are necessary to the business's future vitality are exempt regulatory matters, and not even property of the debtor's estate since the assets were useful only through further regulation. *In re Braniff Airways*, 700 F.2d 935 (5th Cir.1983) (landing slots necessary for reorganization were not subject to bankruptcy court orders over FAA).

On the other hand, there are cases restricting the exemption from the stay to matters directly affecting the public safety, which should not be interrupted pending a hearing to lift the stay. Others have held that some parallel proceedings, like competing license applications, that might require some distraction to the debtor's reorganization efforts are not stayed through the exemption even though they do not involve palpable health hazards. *See Jordan v. Randolph Mills, Inc.*, 716 F.2d 1053 (5th Cir.1983); *In re D.H. Overmyer Telecasting Co., Inc.*, 35 B.R. 400 (Bankr.N.D.Ohio 1983).

10. *Governmental Actions Not Excepted from the Stay.*

Ignoring the distinction between "all" and "police-regulatory" is easy and wrong; by the plain terms of the statute there are governmental actions that are not exempted from the stay. To determine whether a governmental function is among those that should be exempt, the court must evaluate the function of the regulation, the probability of direct public harm, the opportunity for the public interest to be effectively represented in the bankruptcy proceeding, and the relation between the regulation and the financial, legal, and structural requirements for an effective reorganization. *See In re King Memorial Hospital, Inc.*, 4 B.R. 704 (Bankr.S.D.Fla. 1980); *In re Joe DeLisi Fruit Co.*, 11 B.R. 694 (Bankr. D.Minn. 1981).

Both the Board's generalized, diffuse interest in the holding company as well as the duplicative, distracting hearings militate for its being not exempt from the stay.

11. *Reorganization by Subterfuge.*

MCorp argues that the current state of regulatory orders issuing from the Board is effectively an attempt by the Board to control the estate of the Debtor for the purpose of dictating MCorp's future structure. While this appears plausible, it is unnecesary to address it in detail because the stay applies to most of the regulation and because the Board is subject to the anti-interference prohibition. 11 U.S.C. § 105.

The bankruptcy court can scrutinize the potential for undisclosed motivations when the Board presents a motion to lift the stay.

12. *Anti-Interference Authority.*

Whatever the role of the automatic stay, the bankruptcy code authorizes an injunction against third parties from conducting otherwise fully legitimate actions when those actions would impede the viability of the debtor's reorganization. The Board claims an exemption

from the anti-interference power parallel to the regulatory exemption from the automatic stay. Virtually any company is subject to a variety of regulatory agencies, and no reorganization would be possible without requiring the federal, state, and local authorities to submit their claims through the bankruptcy process. Securities issued as a consequence of a bankruptcy supervised reorganization are expressly exempt from the registration requirements of the Securities and Exchange Commission. 11 U.S.C. § 1145.

The court shares the Board's concern that the laudable but limited purposes of bankruptcy not be perverted into an escape from regulation. The bankruptcy process includes a vigilant, fully empowered judge who will prevent individual or collusive efforts to evade the Debtor's responsibilities to the public.

The Board's interest in MCorp, as distinct from the comptroller or FDIC's interest in the banks, is secondary and diffuse. The overlapping authority between bank regulators and bankruptcy courts is resolved in favor of the court. As an example, when responding to a receivership imposed by a district court under the Securities and Exchange Commission's authority, it has been said that "to the extent that the exercise of this jurisdiction threatens the assets of the debtor's estate, the bankruptcy court may issue a stay of those proceedings." *Securities & Exch. Comm'n v. First Fin. Group of Texas*, 645 F.2d 429, 440 (5th Cir. 1981).

13. *Conclusion.*

While the operation of the banking system under the guidance of the Board is an important interest, congress has also recognized the importance of allowing debtors to restructure so that they may make a contribution to the economic vitality of the country. Under the circumstances of a bank holding company with nonbank subsidiaries, accommodation of the two national interests in bankruptcy and banking requires that the bankruptcy

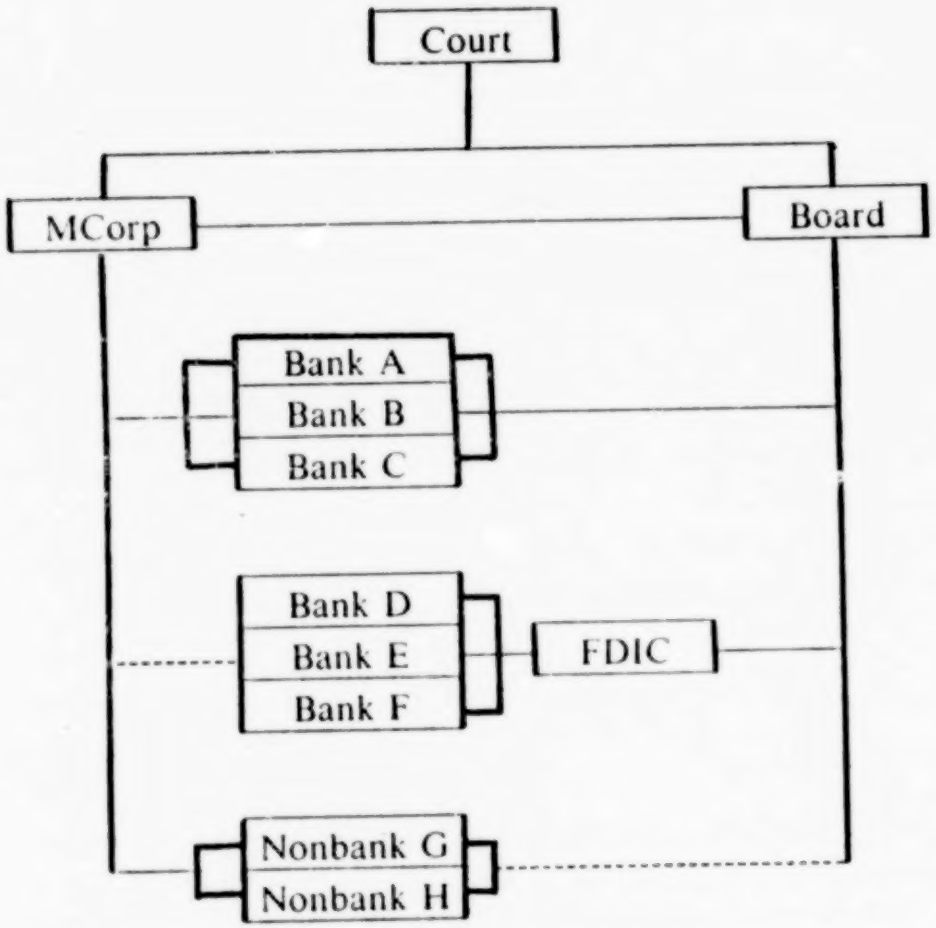
court have primacy over the non-operations aspects of the debtor and that the Board, after participating, abide by the capital allocation and structural aspects of the debtor as determined in the bankruptcy rather than conducting its independent actions.

The court is mindful that a debtor that follows MCorp's precedent may attempt to abuse the opportunity furnished by the bankruptcy code, but the principle here is clear, and it must be applied with care, even here. The court is also mindful of who was paid to prevent the bank practices that resulted in the collapse of the system in the Southwest. Neither side has an occasion for self-righteousness.

The Board will be enjoined to allow the claims in its pending charges to abate, except through the bankruptcy court.

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Background of the Controversy" section of the opinion of June 9, 1989.

APPENDIX A



A-C represent remaining subsidiary banks.

D-F represent subsidiary banks declared insolvent.

G-H represent nonbank subsidiaries.

PRELIMINARY INJUNCTION AGAINST THE FEDERAL RESERVE SYSTEM'S PROCEEDING ADMINISTRATIVELY AGAINST MCORP

1. *Parties.*

A. The parties plaintiff are:

(1) MCorp, a bank holding company;

(2) MCorp Financial, Inc., a non-bank subsidiary of MCorp; and

(3) MCorp Management, a non-bank subsidiary of MCorp.

(4) Each of the plaintiffs are debtors in possession (MCorp collectively).

B. The Official Creditors Committee formed under the bankruptcy statutes has been allowed to intervene.

C. The party defendant is the Board of Governors of the Federal Reserve System of the United States (Board).

2. *Related Proceedings.* This civil action was an adversary proceeding in the consolidated bankruptcy case to reorganize MCorp. and the reference by the district court to the bankruptcy court was withdrawn. (Adversary Number 89-0298.) The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp, and it was 89-02848-H2-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case Number 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case Number 89-02312-H3-11.

D. The three bankruptcy actions have been consolidated under the earliest case number for joint administration.

3. *Reasons.* The court finds these to be reasons to grant injunctive relief:

A. The allocation of power to supervise bank holding companies conflicts when the corporation has sought protection under the bankruptcy statutes, and the conflicts can be minimized only through the intervention of the court.

B. The waste and confusion attendant upon parallel bankruptcy and administrative proceedings would defeat the legislative expectation of both sets of statutes, harm irreparably the estates of the bankrupts and their creditors (including the various governmental claims), escalate transaction costs by duplication and conflict, and protect no public interest or governmental function not fully addressable in the bankruptcy proceeding.

C. Prevalence on the merits in this case appears to be reduced to a correct interpretation of which public forum has precedence when a bank holding company has subsidiaries that include non-banks; however, MCorp is likely to prevail on its claim that the executive's administrative power over bank holding companies is preempted by the bankruptcy power which congress has confided to the judiciary.

D. Neither an interest of the public nor an interest of a group of nonparties will be harmed by this injunctive solution to the regulatory conflict.

4. *Restraint.* It is decreed that:

A. The Board is preliminary enjoined from prosecuting:

(1) Notice of Charges dated October 19, 1988;

(2) Amended Notice of Charges dated October 26, 1988;

(3) Notice of Charges dated March 30, 1989, and;

(4) Second Amended Notice of Charges dated May 24, 1989, issued by the Board to MCorp, and

B. The Board is preliminarily enjoined from enforcing the temporary desist orders issued by the Board to MCorp dated October 19, 1988, and October 26, 1988.

C. The Board may continue its general execution, supervisory, and examination duties of the operations of MCorp and its bank subsidiaries and may continue its central bank duties as they affect MCorp in common with all other institutions.

D. The Board is enjoined from using its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

E. The restraint of this order is effective against the governors, the Federal Reserve System, its employees, its agents, and those acting in concert with them; however, the restraint does not apply to parallel agencies of the government like the Comptroller of the Currency or the Federal Deposit Insurance Corporation as they may independently pursue their regulatory mandates.

5. *Prospective Board Actions.*

A. The Board shall present proposed new administrative proceedings by it against MCorp or the proposed issuance of new notices of charges or new temporary desist orders to MCorp.

B. If the parties cannot agree that the subject of the new proceeding is within the category of regulation exempted from this injunction, then the proposed action shall be presented to this court to determine whether it is an operational issue for the Board or an asset-structural issue for the bankruptcy court.

6. *Further Proceedings.*

A. Under emergency scheduling, the parties may seek modification of this order after notice to the parties.

B. The trial will not be set until the bankruptcy court has had a reasonable opportunity to address the issues raised by MCorp having subsidiaries banks and non-banks.

C. A status conference is set for:

August 15, 1989
10:00 a.m. Tuesday

Signed on June 19, 1989, at Houston, Texas, correcting case numbers and descriptions in the "Related Proceedings" section of the judgment rendered on June 2, 1989, and signed June 3, 1989.

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 19, 1988]

NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this Notice of Charges and of Hearing (the "Notice") in implementation thereof pur-

suant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the State of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. As of the date of this Notice, MCorp owns 26 subsidiary banks and 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controls the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries.

3. The conditions of MCorp and its Subsidiary Banks and Nonbank Subsidiaries have been deteriorating, and the MCorp organization is currently in extremely poor condition, with a large volume of nonperforming assets, inadequate levels of capital protection, opearting losses and insufficient reserves for the kind and quality of its problem assets. In particular:

(a) For the year ending December 31, 1985, MCorp reported that, on a consolidated basis, nonperforming assets were $534 million or 3.5 percent of the organization's total loans and leases. For the year ending December 31, 1986, consolidated nonperforming assets had risen to $1.2 billion or 7.6 percent of MCorp's total loans and

leases. For the year ending December 31, 1987, nonperforming assets on a consolidated basis stood at $1.6 billion or 11.5 percent of the organization's total loans and leases. By the end of the second quarter of 1988, as of June 30, 1988, consolidated nonperforming assets had increased to $1.8 billion or 13.7 percent of total consolidated loans and leases.

(b) (1) For the year ending December 31, 1985, MCorp's consolidated equity capital stood at 5.7 percent of the organization's consolidated total assets. For the year ending December 31, 1986, the company's consolidated equity capital was 5.2 percent of its consolidated total assets. For the year ending December 31, 1987, MCorp's consolidated equity capital had decreased to 4.2 percent of its consolidated total assets. As of the second quarter of 1988, ending June 30, 1988, the organization's equity capital had declined further to 4.1 percent of its total assets. MCorp's tangible primary capital, on a consolidated basis, at the end of the second quarter of 1988, ending June 30, 1988, stood at 5.4 percent of its adjusted total tangible assets.

(2) As of September 30, 1988, the Board of Governors has reasonable cause to believe that (i) MCorp's consolidated equity capital deteriorated further and stood at approximately 1.5 percent of the organization's consolidated total assets, and (ii) MCorp's consolidated equity capital, excluding intangible assets, stood at 0.2 percent of its total tangible assets.

(c) For the year ending December 31, 1985, MCorp reported, on a consolidated basis, net income of $132 million. For the year ending December 31, 1986, MCorp reported, on a consolidated basis, net losses of $82 million. For the year ending December 31, 1987, MCorp reported, on a consolidated basis, net losses of $258 million. For the first half of 1988, ending June 30, 1988, MCorp had a one-time, extraordinary gain in excess of $200 million on the sale of the controlling interest of a nonbank subsidiary, but, because of significant operating

losses, reported consolidated net losses of $12 million. The Board of Governors has reasonable cause to believe that MCorp suffered consolidated losses for the third quarter of 1988 of approximately $525 million, thereby reporting year-to-date net consolidated losses of approximately $537 milion as of September 30, 1988.

(d) As of December 31, 1986, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 37.5 percent of the organization's nonperforming loans. As of December 31, 1986, the reserves for loan losses of the 50 largest bank holding companies in the United States, which included MCorp, averaged 114 percent of nonperforming loans. As of December 31, 1987, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 25.2 percent of the organization's nonperforming loans. As of December 31, 1987, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, average 112 percent of nonperforming loans. As of June 30, 1988, MCorp reported, on a consolidated basis, that the organization's reserves for loan losses were 22.8 percent of the organization's nonperforming loans. As of June 30, 1988, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged over 100 percent of on performing loans.

(e) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp with federal assistance pursuant to section 13(c) of the Act (12 U.S.C. 1823(c)).

4. (a) As a result of the conditions described in paragraph 3 hereof, *i.e.*, the extraordinary high volume of poor quality and nonperforming assets, the conditions of the Subsidiary Banks have deteriorated to critical levels. In particular:

(1) The Minimum Capital Ratios Regulation of the Office of the Comptroller of the Currency (the "OCC") (12 CFR Part 3) provides that the minimally acceptable

ratio of primary capital to total assets for national banking institutions in the soundest and strongest financial conditions is 5.5 percent. The OCC's capital regulation further provides that national banks in unsatisfactory conditions, such as the majority of the 25 Subsidiary Banks that are nationally chartered, are expected to hold additional capital adequate to compensate for their higher levels of risks. The Subsidiary Banks that are national banks, in accordance with the OCC's regulation, are required to maintain capital in excess of the minimally acceptable ratio of 5.5 percent of total assets.

(2) As of June 30, 1988, 20 of the Subsidiary Banks, which represented 78.8 percent of MCorp's total bank assets, had primary capital of less than 5.5 percent of each bank's total assets.

(b) As of the date of this Notice, the Board of Governors has reasonable cause to believe that MCorp's third quarter 1988 losses of about $525 million further depleted the Subsidiary Banks' primary capital, thereby increasing the Subsidiary Banks' capital shortfall well below minimally acceptable capital levels.

5. As of June 30, 1988, the MCorp parent group, which excludes the Subsidiary Banks, had total assets, exclusive of investments in the Subsidiary Banks, in excess of $400 million. As of the date of this Notice, a significant portion of these assets are readily available to be used to fund direct capital contributions to those Subsidiary Banks experiencing capital deficiencies.

6. MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks. In particular:

(a) (1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b)) provides that:

The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter [the BHC Act] and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(3) Under the provisions of law and regulation set forth in paragraphs 6(a)(1) and (2) hereof, a bank holding company, in accordance with Board policy, should use its available resources to provide adequate capital funds to its subsidiary banks, particularly in the event that such assistance is necessary to prevent the deterioration or the failure of any of its subsidiary banks.

(4) As described in paragraph 5 hereof, the MCorp parent group has available assets that could be used where appropriate to fund direct capital contributions to those Subsidiary Banks experiencing capital shortfalls.

(5) By letter dated August 24, 1988, a shareholder and creditor of MCorp advised MCorp that, in its view, MCorp has a duty to preserve sufficient liquid assets and other assets to enable MCorp to pay its debts and dividends on its outstanding preferred stock and that MCorp should not make what the shareholder or creditor believed to be unrecoverable investments in its Subsidiary Banks.

(6) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management in response to pressure from shareholders and creditors will fail to maintain current assets at the parent company level that could be used, where appropriate, to provide adequate capital to the Subsidiary Banks in order to prevent the parent company from becoming a financial drain and to prevent the deterioration of such

banks and thereby will engage in an unsafe and unsound banking practice and a violation of section 225.4 (a)(1) of Regulation Y of the Board of Governors and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

(b) MCorp and its management have engaged in unsafe and unsound dividend practices by using funds to pay cash dividends at a time when the severe financial condition of the Subsidiary Banks warranted capital injections. In particular, for the year ending December 31, 1986, MCorp paid cash dividends on its common stock and preferred stock of approximately $45 million and $11 million, respectively. For the year ending December 31, 1987, MCorp paid cash dividends on its preferred stock of approximately $14 million. During the first three quarters of 1988, ending September 30, 1988, MCorp has paid and/or declared cash dividends on its preferred stock of approximately $12 million. A cash dividend on MCorp's preferred stock in the amount of $840,000 was paid on October 14, 1988, and, unless restrained, additional cash dividends on preferred stock in the approximate amount of $2.0 million will be paid by MCorp on October 25 and November 1, 1988. These cash dividends were paid and would be paid to shareholders in years when MCorp reported operating losses, as described in paragraph 3(c) hereof, in contravention of the Board of Governors Policy Statement on the payment of cash dividends by bank holding companies, issued November 14, 1985 (F.R.R.S. 4-877). Moreover, these cash dividends were paid out to shareholders in years when, as described in paragraphs 3(b) and 4 hereof, the capital of the Subsidiary Banks and MCorp deteriorated below minimally accepted levels and MCorp failed to inject adequate amounts of new capital into the Subsidiary Banks.

7. (a) MCorp and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 5 and 6 hereof.

(b) MCorp and its management have engaged, are engaging and, unless restrained, will continue to engage in the unsafe and unsound practices set forth in paragraphs 3, 4, 5 and 6 hereof. In particular, the Board of Governors has reasonable cause to believe that MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, and (2) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

8. Notice is hereby given that a hearing will be held on December 12, 1988 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices herein specified or to take affirmative action to correct the conditions resulting from such unsafe or unsound practices. Appropriate corrective action may include the issuance of a cease and desist order:

(a) Prohibiting the payment of all cash dividends;

(b) prohibiting the dissipation of parent group assets that could be used to fund capital injections into the Subsidiary Banks, except for the payment of debts in accordance with contractual obligations, corporate salaries and operating expenses; and

(c) such other affirmative actions as may be appropriate under the circumstances of this matter.

9. The hearing referred to in paragraph 8 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the

public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

10. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

11. MCorp is hereby directed to file an answer to this Notice within 20 days of service of this Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Gorverners (12 CFR 263.5(d)), the failure of MCorp to file an answer required by this Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in the Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 19th day of October, 1988.

Board of Governors of the
Federal Reserve System

By: /s/ William W. Wiles
William W. Wiles
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

In re MCorp, Dallas, Texas

[Filed: Oct. 19, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices are otherwise specified in the Notice of Charges and of Hearing (the "Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices of MCorp relating to (1) the deteriorating conditions of MCorp and its 26 subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), and (2) MCorp's payment (and proposed payment) of cash dividends on its preferred stock at times when the bank holding company has suffered and is suffering large operating losses, has inadequate levels of capital protection on a consolidated basis and at its Subsidiary Banks, and significant volumes of problem, non-

performing assets at the Subsidiary Banks and likely to (a) cause the substantial dissipation of the assets of MCorp, (b) weaken seriously the condition of MCorp, or (c) seriously prejudice the interests of some of the Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(c) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)), that:

1. MCorp shall not declare or pay any corporate dividends on its outstanding common or preferred stock without the prior written approval of the Federal Reserve Bank of Dallas and the Staff Director of the Division of Banking Supervision and Regulation of the Board of Governors.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Notice, except to the extent that, and until such time as, any provision of this Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)(2)).

Dated at Washington, D.C., this 19th day of October, 1988.

Board of Governors of the
Federal Reserve System

By: /s/ William W. Wiles
William W. Wiles
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 19, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices are otherwise specified in the Notice of Charges and of Hearing (the "Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices of MCorp relating to (1) the deteriorating conditions of MCorp and its 26 subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), and (2) the extremely poor condition of the MCorp Organization, the large operating losses suffered by MCorp, the inadequate levels of capital protection on a consolidated basis and at MCorp's Subsidiary Banks, and the significant volume of problem, nonperforming assets at the Subsidiary Banks are likely to (a) cause

the substantial dissipation of the assets of MCorp, (b) cause the insolvency of MCorp or some of the Subsidiary Banks, (c) weaken seriously the condition of MCorp or some of the Subsidiary Banks, or (d) seriously prejudice the interests of some of the Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(c) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)) and section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(c)), that:

1. (a) From the effective date of this Temporary Order, MCorp shall not, directly or indirectly, enter into, participate, or in other manner, engage in any transaction that would, in any manner, have the effect of dissipating, or result in the dissipation of, the assets described in paragraph 5 of the Notice attached hereto ("Holding Company Assets") without the prior written approval of the Federal Reserve Bank of Dallas (the "Reserve Bank").

(b) Any request for prior approval pursuant to this paragraph shall be accompanied by documentation adequate to provide the Reserve Bank with the details of each proposed transaction, including a full description of the proposal, the purpose(s) for the transaction, the amounts involved, the benefits to be derived by MCorp and any of its Subsidiary Banks, and such other matters that may be pertinent to the transaction and assist the Reserve Bank in its review of each proposal.

(c) Notwithstanding the requirements of paragraph 1(a) hereof, MCorp may enter into, participate, or in any other manner, engage in any transaction that would have the effect of dissipating, or result in the dissipation of, Holding Company Assets without the prior written

approval of the Reserve Bank if such a transaction involves or relates to: (1) interest payments or principal reductions on any outstanding debt that MCorp is obligated to make pursuant to contractual obligations in effect as of the effective date of this Temporary Order, (2) salaries, but not bonuses, or (3) payments for goods and services, including salaries, being provided to meet the legitimate needs of MCorp that MCorp is obligated to make pursuant to contractual obligations in effect as of the effective date of this Temporary Order.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Notice, except to the extent that, and until such time as, any provision of this Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)(2)).

Dated at Washington, D.C., this 19th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 26, 1988]

AMENDED NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices and violations, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this amended Notice of Charges

and of Hearing (the "Amended Notice"), which amends the Notice of Charges and of Hearing issued against MCorp on October 19, 1988, in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act"), (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Amended Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the States of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. As of the date of this Amended Notice, MCorp owns 26 subsidiary banks and 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controls the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries.

3. The conditions of MCorp and its Subsidiary Banks and Nonbank Subsidiaries have been deteriorating, and the MCorp organization is currently in extremely poor condition, with a large volume of nonperforming assets, inadequate levels of capital protection, operating losses and insufficient reserves for the kind and quality of its problem assets. In particular:

(a) For the year ending December 31, 1985, MCorp reported that, on a consolidated basis, nonperforming as-

sets were $534 million or 3.5 percent of the organization's total loans and other nonperforming assets. For the year ending December 31, 1986, consolidated nonperforming assets had risen to $1.2 billion or 7.6 percent of MCorp's total loans and other nonperforming assets. For the year ending December 31, 1987, nonperfoming assets on a consolidated basis stood at $1.6 billion or 11.5 percent of the organization's total loans and other nonperforming assets. By the end of the third quarter of 1988, as of September 30, 1988, consolidated nonperforming assets had increased to $2.0 billion or 15.7 percent of total consolidated loans and other nonperforming assets.

(b)(1) For the year ending December 31, 1985, MCorp's consolidated equity capital stood at 5.7 percent of the organization's consolidated total assets. For the year ending December 31, 1986, the company's consolidated equity capital was 5.2 percent of its consolidated total assets. For the year ending December 31, 1987, MCorp's consolidated equity capital had decreased to 4.2 percent of its consolidated total assets. As of the second quarter of 1988, ending June 30, 1988, the organization's equity capital had declined further to 4.1 percent of its total assets.

(2) As of September 30, 1988, MCorp's consolidated equity capital deteriorated further and stood at approximately 1.7 percent of the organization's consolidated total assets, and its consolidated equity capital, excluding intangible assets, stood at 0.3 percent of its total tangible assets.

(c) For the year ending December 31, 1985, MCorp reported, on a consolidated basis, net income of $132 million. For the year ending December 31, 1986, MCorp reported, on a consolidated basis, net losses of $82 million. For the year ending December 31, 1987, MCorp reported, on a consolidated basis, net losses of $258 million. For the first half of 1988, ending June 30, 1988, MCorp had a one-time, extraordinary gain in excess of

$200 million on the sale of the controlling interest of a nonbank subsidiary, but, because of significant operating losses, reported consolidated net losses of $12 million. In the third quarter of 1988, MCorp suffered consolidated losses of $517 million, thereby reporting year-to-date net consolidated losses of $529 million as of September 30, 1988.

(d) As of December 31, 1986, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 39.1 percent of the organization's nonperforming assets. As of December 31, 1986, the reserves for loan losses of the 50 largest bank holding companies in the United States, which included MCorp, averaged 63 percent of nonperforming assets, on a weighted basis. As of December 31, 1987, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 26.3 percent of the organization's nonperforming assets. As of December 31, 1987, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged 80 percent of nonperforming assets, on a weighted basis. As of September 30, 1988, MCorp reported, on a consolidated basis, that the organization's allowance for possible losses on loans and foreclosed property was 36.9 percent of the organization's nonperforming assets. As of June 30, 1988, the reserves for loan losses of the 50 largest bank holding companies in the United States, including MCorp, averaged about 91 percent of nonperforming assets, on a weighted basis.

(e) On November 4, 1986, MCorp entered into a Memorandum of Understanding (the "MOU") with the Federal Reserve Bank of Dallas, which provided, *inter alia*, that "MCorp will take all necessary steps to ensure that adequate capital positions are maintained at the holding company and at each of its subsidiary banks and nonbank subsidiaries".

(f) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp

with federal financial assistance, pursuant to section 13(c) of the Act (12 U.S.C. 1823(c)); and the Federal Deposit Insurance Corporation has subsequently informed MCorp that, as a condition to proceeding with such assistance, MCorp should immediately use its available assets to support the Subsidiary Banks.

(g) On October 24, 1988, MCorp announced that (1) the board of directors of MCorp declared a moratorium on the payment of principal and interest on all parent company public and privately placed indebtedness for borrowed money, (2) the debt moratorium will remain in place until further notice, (3) the moratorium permits MCorp to marshall its assets in connection with its recapitalization proposal, and (4) the resources retained through the moratorium, coupled with the other assets of the company, are intended to be used in connection with the recapitalization of the company and its banking subsidiaries.

4. As a result of the conditions described in paragraph 3 hereof, *i.e.*, the extraordinary high volume of poor quality and nonperforming assets, the conditions of the Subsidiary Banks have deteriorated to critical levels. In particular:

(a) The Minimum Capital Ratios Regulation of the Office of the Comptroller of the Currency (the "OCC") (12 CFR Part 3) provides that the minimally acceptable ratio of primary capital to total assets for national banking institutions in the soundest and strongest financial conditions is 5.5 percent. The OCC's capital regulation further provides that national banks in unsatisfactory conditions, such as the majority of the 26 Subsidiary Banks that are nationally chartered, are expected to hold additional capital adequate to compensate for their higher levels of risks. The Subsidiary Banks that are national banks, in accordance with the OCC's regulation, are required to maintain capital in excess of the minimally acceptable ratio of 5.5 percent of total assets.

(b) As of September 30, 1988, 22 of the Subsidiary Banks had primary capital ratios below 5.5 percent of their total assets.

(c) In order to increase the capital accounts of the Subsidiary Banks that have primary capital ratios below 5.5 percent to applicable regulatory capital requirements, the banks would need capital injections of between $420 and $430 million.

(d) The Board of Governors has reasonable cause to believe that, based on the volume of classified assets at the Subsidiary Banks, their earnings and other related factors, some of the Subsidiary Banks are in danger of failing in the absence of increases in their capital accounts.

(e) On or about October 27, 1988, the Office of the Comptroller of the Curency (the "OCC") (1) will issue notices of its intent to issue capital directives, pursuant to the International Lending Supervision Act of 1983 (12 U.S.C. 3907 *et seq.*), to 18 of the nationally chartered Subsidiary Banks, (2) will require these banks to attain primary capital ratios of 4.5 percent, and (3) will provide these banks with a period of two days to respond to the OCC's notices.

5. (a) As of September 30, 1988, the MCorp parent group, which excludes the Subsidiary Banks, had total assets in excess of $400 million. As of the date of this Amended Notice, a significant portion of these assets are available to be used to fund direct capital contributions to those Subsidiary Banks experiencing capital deficiencies.

(b) As of the date of this Amended Notice, the available assets of MCorp described in paragraph 5(a) hereof are sufficient to increase the capital accounts of those Subsidiary Banks with inadequate capital to minimum levels.

6. Given MCorp's past failure to support adequately its Subsidiary Banks, its failure to comply with the capital provision of the MOU, and representations by MCorp management to the staff of the Board of Governors, the Board of Governors has reasonable cause to believe that

MCorp will not use any of its available assets to make direct capital contributions to the Subsidiary Banks that have levels of capital protection below the standards set by the Subsidiary Banks' primary federal regulator.

7. MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks' depositors, and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks. In particular:

(a) (1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b) provides that:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter (the BHC Act) and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(3) Under the provisions of law and regulation set forth in paragraphs 7(a)(1) and (2) hereof, a bank holding company, in accordance with Board of Governors' Policy Statement on the responsibility of bank holding companies to act as sources of strength to their subsidiary banks, should use its available resources to provide adequate capital funds to its subsidiary banks, particularly in the event that such assistance is necessary to prevent the deterioration or the failure of any of its subsidiary banks.

(4) As described in paragraph 5 hereof, the MCorp parent group has available assets that could be used where appropriate to fund direct capital contributions to those Subsidiary Banks that do not meet applicable regulatory capital requirements.

(5) By letter dated August 24, 1988, a shareholder and creditor of MCorp advised MCorp that, in its view, MCorp has a duty to preserve sufficient liquid assets and other assets to enable MCorp to pay its debts and dividends on its outstanding preferred stock and that MCorp should not make what the shareholder and creditor believed to be unrecoverable investments in its Subsidiary Banks.

(6) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management in response to pressure from shareholders and creditors will fail to maintain current assets at the parent company level that could be used, where appropriate, to provide adequate capital to the Subsidiary Banks in order to prevent the deterioration of such banks and thereby will engage in an unsafe and unsound banking practice and a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

(7) As a result of the conditions and practices described in paragraphs 3, 4, 5, and 6 hereof, most of the Subsidiary Banks are in critical financial condition, and they will continue to deteriorate unless MCorp makes immediate capital injections in accordance with the requirements of the Subsidiary Banks' primary federal regulator.

(8) By failing to use available assets to make needed capital injections into Subsidiary Banks with capital deficiences as the financial conditions of such banks have deteriorated, MCorp and its management improperly limited the company's ability to enhance the Subsidiary Banks' capital and, thereby, threatened the continued financial viability of the Subsidiary Banks. Thus, MCorp and its management have engaged in an unsafe and unsound practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the capital provision of the MOU that adversely affected MCorp's condition and the conditions of the Subsidiary Banks and that limited MCorp's ability to serve as a source of financial strength to the Subsidiary Banks. In particular, as set forth in paragraph 5 hereof, MCorp had funds available to inject needed capital into the Subsidary Banks and, as of the date of this Amended Notice, McCorp, as the Subsidiary Banks' parent holding company and sole shareholder, has failed to inject the adequate capital funds into the Subsidiary Banks to prevent their deterioration.

(9) The Board of Governors has reasonable cause to believe that, unless restrained, MCorp and its management will fail to use its available resources to provide adequate capital to the Subsidiary Banks in order to prevent the continued deterioration of such banks and thereby will engage in an unsafe and unsound banking practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the MOU that would adversely affect MCorp's condition and the conditions of the Subsidiary Banks and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks. In particular, the Board of Governors has reasonable cause to believe that the financial condition of the MCorp organization will continue to deteriorate and that MCorp will not take such actions as are necessary to recapitalize one or more of the Subsidiary Banks after it is determined by the banks' primary federal regulator that the Subsidiary Banks' capital accounts are deficient.

(b) MCorp and its management have engaged in unsafe and unsound dividend practices by using funds to pay cash dividends at a time when the severe financial condition of the Subsidiary Banks warranted capital in-

jections. In particular, for the year ending December 31, 1986, MCorp paid cash dividends on its common stock and preferred stock of approximately $45 million and $11 million, respectively. For the year ending December 31, 1987, MCorp paid cash dividends on its preferred stock of approximately $14 million. During the first three quarters of 1988, ending September 30, 1988, MCorp has paid cash dividends on its preferred stock of approximately $12 million. A cash dividend on MCorp's preferred stock in the amount of $840,000 was paid on October 14, 1988, and additional cash dividends on preferred stock in the approximate amount of $2.0 million were to be paid by MCorp on October 25 and November 1, 1988 but were halted by the issuance of a temporary cease and desist order by the Board of Governors. These cash dividends were paid to shareholders in years when MCorp reported operating losses, as described in paragraph 3(c) hereof, in contravention of the Board of Governors' Policy Statement on the payment of cash dividends by bank holding companies, issued November 14, 1985 (F.R.R.S. 4-877). Moreover, these cash dividends were paid out to shareholders in years when, as described in paragraphs 3(b), 4 and 6 hereof, the capital of the Subsidiary Banks and MCorp deteriorated below minimally accepted levels and MCorp failed to inject adequate amounts of new capital into the Subsidiary Banks.

8. (a) MCorp and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 6, and 7 hereof.

(b) MCorp and its management have engaged, are engaging and, unless restrained, will continue to engage in the unsafe and unsound practices and violations of law and regulation set forth in paragraphs 3, 4, 6, and 7 hereof. In particular, the Board of Governors has reasonable cause to believe that MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, (2) to

use all available resources to make immediate capital injections into the Subsidiary Banks described in paragraph 4 hereof, and (3) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

9. Notice is hereby given that a hearing will be held on December 12, 1988 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices herein specified or to take affirmative action to correct the conditions resulting from such unsafe or unsound practices. Appropriate corrective action may include the issuance of a cease and desist order:

(a) Prohibiting the payment of all cash dividends;

(b) prohibiting the dissipation of parent group assets that could be used to fund capital injections into the Subsidiary Banks, except for the payment of debts in accordance with contractual obligations, corporate salaries and operating expenses;

(c) requiring compliance with the capital provision of the MOU;

(d) requiring the implementation of an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies;

(e) taking all necessary actions to ensure compliance with any orders or capital directives issued by the OCC relating to the capital needs of the Subsidiary Banks and reporting to the Board of Governors concerning which Subsidiary Banks will receive capital injections from MCorp; and

(f) such other affirmative actions as may be appropriate under the circumstances of this matter.

10. The hearing referred to in paragraph 9 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

11. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Amended Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Amended Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

12. MCorp is hereby directed to file an answer to this Amended Notice within 20 days of service of this Amended Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(d)), the failure of MCorp to file an answer required by this Amended Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Amended Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in this Amended Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 26th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-C-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: Oct. 26, 1988]

TEMPORARY ORDER TO CEASE AND DESIST

In consideration of the unsafe and unsound practices and violation of law and regulation that MCorp, Dallas, Texas ("MCorp"), has engaged, is engaging and, unless restrained, will continue to engage in, and as such practices and violation are otherwise specified in the Amended Notice of Charges and of Hearing (the "Amended Notice") attached hereto and made a part hereof, the Board of Governors of the Federal Reserve System (the "Board of Governors") has determined that the referenced unsafe and unsound practices and violation of MCorp relating to (1) the deteriorating conditions of MCorp and its subsidiary banks (referred to herein collectively as the "Subsidiary Banks"), (2) the possible failure of some of the Subsidiary Banks in the absence of prompt capital assistance, and (3) MCorp's failure to comply with the capital provision of the Memorandum of Understanding, dated November 4, 1988, between MCorp and the Federal Reserve Bank of Dallas and its failure to

serve as a source of financial strength to the Subsidiary Banks by failing to inject its available assets as capital into those Subsidiary Banks that are experiencing capital deficiencies and asset quality problems are likely to (a) weaken seriously the condition of those Subsidiary Banks with inadequate levels of capital protection, or (b) seriously prejudice the interests of such Subsidiary Banks' depositors prior to the completion of the administrative proceedings ordered by the Board of Governors in the Amended Notice.

The Board of Governors therefore hereby issues this Temporary Order to Cease and Desist (the "Temporary Order") and hereby orders, pursuant to section 8(a) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)) and section 5(b) of the Bank Holding Company Act of 1965, an amended (12 U.S.C. 1844(c)), that:

1. MCorp shall (a) take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks in need of additional capital, and (b) within 15 days of the effective date of this Temporary Order, report to the Board of Governors on the identity of those Subsidiary Banks into which capital injections will be made by MCorp and the amount of capital to be injected into each such bank. In reviewing MCorp's proposed capital injections, the Board of Governors shall take into account any orders or capital directives issued with respect to the Subsidiary Banks by their primary bank regulator. The Board of Governors may issue such further temporary orders to cease and desist as may be necessary to implement this Temporary Order.

2. All communications regarding this Temporary Order shall be sent to:

Mr. Robert D. Hankins
Vice President
Federal Reserve Bank of Dallas
Station K
Dallas, TX 75222

3. This Temporary Order shall become effective immediately upon service on MCorp and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Amended Notice, except to the extent that, and until such time as, any provision of its Temporary Order shall have been stayed, modified, suspended, or set aside by the Board of Governors or by a court in proceedings authorized by section 8(c)(2) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818(c)(2)).

Dated at Washington, D.C. this 26th day of October, 1988.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B2-HC

IN RE MCORP, DALLAS, TEXAS

and

MCORP MANAGEMENT, DALLAS, TEXAS

[Filed: Mar. 30, 1989]

NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, and MCorp Management, Dallas, Texas ("MCorp Management"), a nonbank subsidiary of MCorp, have engaged, are engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law in conducting the business of MCorp and MCorp Management, and that, as a result of the violations, the financial condition of

MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp or MCorp Management and issues this Notice of Charges and of Hearing (the "Notice"), in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818 (b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the States of Delaware and Texas, is and has been at all times pertinent to the charges herein a registered bank holding company. MCorp, therefore, is and has been at all times pertinent to the charges herein subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. MCorp Management, a corporation existing and doing business under the laws of the State of Texas, is and has been at all times pertinent to the charges herein a nonbank subsidiary of MCorp. MCorp Management, therefore, is and has been at all times pertinent to the charges herein subject to the Act, the BHC Act and the rules and regulations of the Board of Governors.

3. Until March 29, 1989, MCorp owned 25 subsidiary banks and, as of the date of this Notice, 17 active nonbank subsidiaries (referred to herein collectively as the "Subsidiary Banks" and the "Nonbank Subsidiaries", respectively), and, by virtue of such ownership, controlled

the affairs and management of the Subsidiary Banks and the Nonbank Subsidiaries. As of the date of this Notice, MCorp continues to own 5 Subsidiary Banks.

4. Section 23A of the Federal Reserve Act ("Section 23A") (12 U.S.C. 371c) provides, *inter alia*, that member banks, such as the Subsidiary Banks, may not extend credit to an affiliate unless at the time of the transaction the extension of credit is fully secured by collateral having a market value of at least 100 percent of the amount of the extension of credit.

5. (a) MCorp and its management and MCorp Management and its management have violated Section 23A by causing two of the Subsidiary Banks—MBank Preston, Texas ("MBank Preston") and MBank Houston, Houston, Texas ("MBank Houston)—to extend credit of approximately $63.7 million to an affiliate, MCorp Management, on an unsecured basis in violation of Section 23A. In particular:

(1) In 1985, MCorp established a Delaware credit card bank, MBank USA, which was a subsidiary of one of MCorp's Nonbank Subsidiaries, MNet, Dallas, Texas ("MNet"). MBank USA was funded, in part, by the advancement of federal funds from MBank Preston and MBank Houston. As part of this transaction, MBank USA agreed to pay MBank Preston and MBank Houston a percentage of the income earned on its credit card operations up to a fixed dollar amount of approximately $79.9 million over an eight year period.

(2) In 1986, MCorp sold MNet, and with it MBank USA, to Lomas & Nettleton Financial Corporation, Dallas, Texas ("L&N"). At that time, MBank Preston and MBank Houston released MBank USA from all of its obligations to them. At the same time, MCorp Managment, a wholly owned Nonbank Subsidiary of MCorp and an affiliate of the Subsidiary Banks, agreed that it would pay MBank Preston and MBank Houston on a quarterly basis, up to a fixed dollar amount, a percentage of the income amount earned by the MCorp organi-

zation from the preferred stock and debentures received from L&N as partial consideration for MBank USA. In particular, MCorp Management agreed to pay MBank Preston and MBank Houston up to approximately $63.7 million over a seven year period.

(b) (1) The agreement in 1986 of MCorp Management to pay MBank Preston and MBank Houston up to approximately $63.7 million over a seven year period represents extensions of credit by these two Subsidiary Banks to an affiliate. MCorp Management's obligations to pay MBank Preston and MBank Houston were unsecured extensions of credit that violated the provisions of Sections 23A at the time the extensions were made.

(2) Since 1986, MCorp Management has paid approximately $8.4 million on its unsecured extensions of credit from its affiliates, MBank Preston and MBank Houston. These payments reflect the maximum amounts owed to MBank Preston through March 31, 1987 and to MBank Houston through December 31, 1987 under the 1986 payment agreements. MBank Preston subsequently was merged in to [*sic*] MBank Dallas, Dallas, Texas ("MBank Dallas"), which succeeded to MBank Preston's rights under the agreement with MCorp Management. As of the date of this Notice, MCorp Management is past due on its unsecured extension of credit from MBank Dallas by as much as $7.9 million and is past due on its unsecured extension of credit from MBank Houston by as much as $6.9 million. As of the date of this Notice, the Board of Governors has reasonable cause to believe that MCorp Management has failed to repay these extensions of credit on a timely basis despite L&N's timely dividends and debt payments to the MCorp organization on the L&N preferred stock and debentures held by the MCorp organization.

6. As of the date of this Notice, MCorp and its management and MCorp Management and its management have engaged, are engaging and, unless restrained, will continue to engage in unsafe and unsound practices in

that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit described in paragraph 4 hereof, (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

7. (a) MCorp and its management and MCorp Management and its management have failed to operate MCorp, the Subsidiary Banks and the Nonbank Subsidiaries in a lawful and safe and sound manner as set forth in paragraphs 5 and 6 hereof.

(b) MCorp and its management and MCorp Management and its management have engaged, are engaging and, unless restrained, will continue to engage in the practices and violations of law set forth in paragraphs 5 and 6 hereof. In particular, the Board of Governors has reasonable cause to believe that, prior to the insolvency of some of the Subsidiary Banks on March 28, 1989, MCorp and MCorp Management did not take the actions that were necessary to correct the violations of Section 23A of the Federal Reserve Act and to record and report properly the transactions described in this Notice.

8. As of the date of this Notice, the Board of Governors has reasonable cause to believe that a petition to place MCorp into involuntary bankruptcy has been filed by several of its creditors and that MCorp has stated that it intends to convert the involuntary bankruptcy into a voluntary reorganization under the provisions of Chapter 11 of the Federal Bankruptcy Code. The Board of Governors is of the opinion that the commencement and continuation of the proceedings against MCorp or MCorp

Management instituted by this Notice would be exempt from the automatic stay provisions of the Federal Bankruptcy Code.

9. Notice is hereby given that a hearing will be held on May 29, 1989 at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp and MCorp Management to cease and desist from the practices and violations of law herein specified or to take such affirmative action as may be appropriate under the circumstances of this matter.

10. The hearing referred to in paragraph 9 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

11. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

12. The provisions of this Notice do not supersede, modify, or, in any other manner, effect the provisions of the Amended Notice of Charges and of Hearing issued against MCorp by the Board of Governors on October 26, 1988.

13. MCorp and MCorp Management are hereby directed to file answers to this Notice within 20 days of service of this Notice as provided by section 263.5(a) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(a)). As provided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5(d)), the failure of MCorp or MCorp Management to file an answer required by this Notice within the time provided herein shall constitute a waiver, as the case may be, of MCorp's of MCorp Management's right to appear and contest the allegations of this Notice and authorization for the presiding officer, without further notice to MCorp or MCorp Management, as the case may be, to find the facts to be as alleged in this Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this 30th day of March, 1989.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B2-HC

IN RE MCORP, DALLAS, TEXAS

and

MCORP MANAGEMENT, DALLAS, TEXAS

[Filed: Apr. 19, 1989]

ANSWER OF MCORP AND MCORP MANAGEMENT TO NOTICE OF CHARGES AND OF HEARING

MCorp and McCorp Management, each a Debtor and Debtor-in-Possession in a Chapter 11 case under Title 11 of the United States Code, hereby answer the Notice of Charges and of Hearing (the "Notice") issued by the Board of Governors of the Federal Reserve System ("Board") on or about March 30, 1989, as follows:

STAY

1. On or about March 21, 1989, an involuntary petition under Chapter 7 of Title 11 of The United States Code (the "Bankruptcy Code") was filed against MCorp in the United States Bankruptcy Court for the Southern

District of New York. Pursuant to an Order of said Court dated March 31, 1989, MCorp converted said case to a case under Chapter 11 of the Bankruptcy Code. In addition, the MCorp Chapter 11 case was transferred to the United States Bankruptcy Court for the Southern District of Texas, Houston Division (the "Houston Court"), by Order of the United States Bankruptcy Court for the Southern District of New York dated April 4, 1989.

2. On March 31, 1989, MCorp Management filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the Houston Court. A Chapter 11 petition also was filed on that date and in that Court by MCorp Financial, Inc., a nonbank subsidiary of MCorp, and those cases are being jointly administered pursuant to an order of the Houston Court dated March 31, 1989. An Order for joint administration to consolidate the cases of MCorp, MCorp Management, and MCorp Financial, Inc. for administrative purposes has been sought.

3. Pursuant to 11 U.S.C. § 362(a), the filing of the Chapter 7 petition against MCorp on March 21, 1989, operated as a stay, applicable to all entities, of the commencement of any administrative proceeding against MCorp. Therefore, the filing and service of the Notice by the Board against MCorp on March 30, 1989, violated the automatic stay imposed by federal law. Accordingly, said Notice is void and a nullity as to MCorp. Moreover, the filing on March 31, 1989 of a voluntary petition for relief under Chapter 11 of the Bankruptcy Code by MCorp Management operated as an automatic stay of the continuation of any administrative proceeding against MCorp Management, including the one commenced by the Notice. Accordingly, this proceeding is now stayed as a matter of federal law.

4. MCorp and McCorp Management intend to file in the Houston Court an adversary proceeding against the Board, as Defendant, seeking injunctive relief against the Board, together with a motion for a temporary restrain-

ing order and a preliminary injunction against, *inter alia*, the continuation of this proceeding by the Board in violation of the automatic stay. MCorp and MCorp Management anticipate that said Court will grant said motion and enforce the stay, and respectfully request that the presiding officer of this proceeding similarly recognize the stay of the continuation of this proceeding forthwith.

5. Without waiver of said stay or their right to insist upon and enforce said stay, but expressly asserting and relying thereon, MCorp and MCorp Management nevertheless answer the Notice as follows.

DEFENSES

6. The charges made by the Board against MCorp and MCorp Management are without basis in law or in fact for each of the following reasons:

A. As of the date of the Notice and of this date, MBank Preston, N.A. ("MBank Preston") no longer existed and neither MBank Dallas, N.A. ("MBank Dallas") as successor by merger to MBank Preston, nor MBank Houston, N.A. ("MBank Houston") existed as a national banking association or was under the control of MCorp or MCorp Management because their respective charters had been revoked by the Comptroller of the Currency on or about March 28, 1989, when they were declared insolvent by the Comptroller of the Currency. Accordingly, neither MCorp nor MCorp Management are bank holding companies with respect to MBank Preston, MBank Dallas, or MBank Houston. It is not alleged, nor can it be alleged in good faith, that MCorp or MCorp Management is capable of causing either of said banks to take any action at this time, or that any circumstances similar to those which are the subject of this proceeding exist or have existed at any time with respect to any bank subsidiary now owned directly or indirectly by MCorp or MCorp Management. Accordingly, and because the only proper purpose of this proceeding is remedial rather than compensatory or punitive, there are no grounds for issuance of any cease-and-desist order or order to take other affirmative action against MCorp or MCorp Management in this proceeding on the basis of the claims alleged in the Notice.

B. Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c ("Section 23A"), is applicable to and restricts certain activities of member banks, and not of bank holding companies or nonbank subsidiaries of bank holding companies like MCorp and MCorp Management, respectively. Accordingly, MCorp and MCorp Management did not and could not violate Section 23A as alleged.

C. The Board is not the "appropriate Federal banking agency" within the meaning of 12 U.S.C. § 1813(g) to initiate and prosecute cease and desist proceedings with respect to violations of Section 23A allegedly committed by MBank Preston, MBank Dallas or MBank Houston, all of which were, prior to March 29, 1989, national banking associations subject to the primary jurisdiction of the Office of the Comptroller of the Currency. Therefore, pursuant to the express terms of 12 U.S.C. § 1818(b), the Board is without any jurisdiction or power whatsoever to conduct this proceeding.

D. The advancements of federal funds from MBank Preston and MBank Houston described in Section 5(a)(1) of the Notice were exempt from the collateralization requirements and quantitative limitations of Section 23A and none of the transactions described in Section 5(a)(2) of the Notice constituted an "extension of credit" or a "covered transaction" within the meaning of Section 23A, as alleged in Section 5(b)(1).

E. Prior to the date of the Notice, all amounts allegedly then owed or due and payable by MCorp

Management to MBank Dallas or MBank Houston had been released and/or satisfied by the course of dealing of the parties and by offset.

F. Neither MCorp nor MCorp Management are bank holding companies with respect to MBank Dallas, MBank Houston or MBank Preston. Therefore, the Board is without any jurisdiction or power whatsoever to conduct this proceeding.

G. The transactions at issue have been properly recorded and reported on MCorp Management's books, records and financial statements.

RESPONSES TO SPECIFIC ALLEGATIONS

7. MCorp and MCorp Management admit the allegations of Paragraph 1 of the Notice, except that they deny that MCorp is a bank holding company with respect to MBank Dallas, MBank Preston or MBank Houston, further deny that MCorp is subject to the Act, the BHC Act and the rules and regulations of the Board with respect to the charges contained in the Notice, and further deny that MCorp is incorporated under the laws of Texas. Defendants further assert that all of the assets of MCorp and MCorp Management are in *custodia legis* and are subject to the exclusive jurisdiction of the Houston Court, and are to be administered pursuant to the bankruptcy laws, which preempt, supersede and override all other laws, rules and regulations.

8. MCorp and MCorp Management admit the allegations of Paragraph 2 of the Notice, except to deny that MCorp Management is subject to the Act, the BHC Act and the rules and regulations of the Board with respect to the charges contained in the Notice, and that they assert that all of the assets of MCorp and MCorp Management are in *custodia legis* and are subject to the exclusive jurisdiction of the Houston Court, and are to be administered pursuant to the bankruptcy laws, which

preempt, supersede and override all other laws, rules and regulations.

9. MCorp and MCorp Management admit that, directly or indirectly through MCorp Financial, Inc., MCorp owned approximately 26 subsidiary banks immediately prior to March 28, 1989, and, as of the date of the Notice, it directly or indirectly owned approximately 17 nonbank subsidiaries; that, by virtue of such ownership, it had only such "control" of such subsidiaries as is appropriate and lawful for a bank holding company; and that as of the date of the Notice, MCorp continued to own, directly or indirectly, approximately 6 subsidiary banks; and MCorp and MCorp Management otherwise deny the allegations of Paragraph 3 of the Notice.

10. MCorp and MCorp Management admit the allegations of Paragraph 4 of the Notice as a general and partial summary of Section 23A.

11. MCorp and MCorp Management deny the allegations of Paragraph 5 of the Notice, except admit:

(A) that MBank U.S.A. ("MBank USA") was created in 1985 and was a credit card bank subsidiary of MNet Corp. ("MNet"), which was a nonbank indirect subsidiary of MCorp; that MBank Preston and MBank Houston sold federal funds to MBank USA; and that, in addition to agreeing to repay said federal funds with interest, MBank USA agreed to pay MBank Preston and MBank Houston certain additional Contingent Fees based upon the future net income of MBank USA, if any;

(B) that on or about December 30, 1986, the stock of MNet was sold to Lomas & Nettleton Financial Corporation ("L&N"); that on that date all outstanding federal funds advances were fully repaid to MBank Preston and MBank Houston with interest and MBank Preston and MBank Houston released MBank USA from all obligations, including the obligation to pay Contingent Fees to them, and

simultaneously therewith, in substitution of the aforementioned contingent fee arrangement involving MBank USA, MCorp Management agreed to pay MBank Preston and MBank Houston, on a quarterly basis through 1993, a percentage of the interest and dividends it might receive on certain notes and preferred stock of L&H, up to a combined maximum aggregate amount of approximately $63.7 million, which agreement did not constitute an "extension of credit;" and that no funds or other property of MBank Houston, MBank Dallas, or MBank Preston were ever received by MCorp Management in exchange or in consideration for such agreement;

(C) that MCorp Management made cash payments aggregating approximately $8.4 million to MBank Preston and MBank Houston pursuant to the aforementioned agreement; that these payments reflected the contingent payments due to MBank Preston through March 31, 1987 and to MBank Houston through December 31, 1987 under the December 30, 1986 agreements referred to in subsection (B) above; and that MBank Preston was subsequently merged into MBank Dallas.

12. MCorp and MCorp Management deny the allegations of Paragraph 6 of the Notice.

13. MCorp and MCorp Management deny the allegations of Paragraph 7 of the Notice.

14. MCorp and MCorp Management admit the allegations in the first sentence of Paragraph 8 of the Notice, deny that commencement or continuation of these proceedings is exempt from the automatic stay provision of 11 U.S.C. § 362, and are without knowledge as to the remaining allegations of Paragraph 8 of the Notice and therefore deny the same.

15. MCorp and MCorp Management assert that this proceeding is stayed and therefore deny the allegations of Paragraphs 9 through 13 of the Notice.

WHEREFORE, MCorp and MCorp Management respectfully request that this proceeding be stayed for all purposes and, without waiver of but subject to such request, pray that the charges set forth in the Notice be found to be without merit and dismissed; that no order to cease and desist or take other action be entered against MCorp or MCorp Management; and that MCorp and MCorp Management be granted such other relief to which they may be entitled.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC., MCORP MANAGEMENT, AND MCORP, ETC., DEBTORS.
MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

COMPLAINT

Plaintiffs MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in possession in these chapter 11 cases (collectively, the "debtors"), by their attorneys, Weil, Gotshal & Manges, as and for their

complaint against the Board of Governors of the Federal Reserve System of the United States of America (the "Board"), aver as follows:

Summary of Relief Requested

1. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp.

2. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer its chapter 11 case to this Court. By orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Rule 1015 "Bankruptcy Rules").

3. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. Pursuant to this Complaint, the Debtors seek an order and judgment (1)(a) declaring that certain administrative proceedings heretofore initiated by the Board are stayed pursuant to the automatic stay extant under section 362(a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining and restraining the Board from continuing the prosecution of such administrative proceedings pursuant to section 105(a) of

the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court granted after notice to the Debtors and a hearing.

Jurisdiction, Venue and the Parties

5. This adversary proceeding is an action for injunctive relief pursuant to sections 105(a) and 362 of the Bankruptcy Code and Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding by Bankruptcy Rules 7001 and 7065.

6. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1134, and venue is proper in this district pursuant to 28 U.S.C. § 1409.

7. This adversary proceeding is a "core proceeding" pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

8. Plaintiff MCorp is a corporation organized and existing under the laws of the State of Delaware with principal places of business at 910 Travis Street, Houston, Texas 77252 and 1717 Main Street, Dallas, Texas 75201.

9. Plaintiff MCorp Financial is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 1105 North Market Street, Wilmington, Delaware 19801, and is a wholly owned subsidiary of MCorp.

10. Plaintiff MCorp Management is a corporation organized and existing under the laws of the State of Nevada, with principal places of business at 910 Travis Street, Houston, Texas 77252 and 1717 Main Street, Dallas, Texas 75201, and is a wholly owned subsidiary of MCorp Financial.

11. Defendant Board is an agency or instrumentality of the United States of America, which may be served with process herein by service of the Summons and Com-

plaint on Henry K. Oncken, United States Attorney for the Southern District of Texas, 515 Rusk Avenue, Houston, Texas, by sending a copy thereof by registered mail to Richard Thornburgh, Attorney General of the United States, Washington, D.C., and by sending a copy thereof by certified mail to the Board in Washington, D.C.

Background of the Debtors

12. Prior to the actions taken by certain federal banking regulators on March 28 and 29, 1989 that are described below, MCorp and its subsidiaries comprised a banking and financial services enterprise, which, among other things, owned and operated twenty-five MBanks with approximately 85 branch offices serving approximately 33 communities in the State of Texas.

13. As of December 31, 1988, the MCorp banking subsidiaries had combined assets totalling more than $17 billion.

14. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for MCorp Management, the MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the MBanks and other MCorp subsidiaries.

Efforts to Recapitalize

15. To offset the continuing losses from the prolonged deterioration of asset values in the depressed Texas economy and the consequent need to make substantial allowances for possible loan losses, beginning in the Fall of 1987 MCorp attempted to recapitalize, without federal assistance, through the sale of assets and the issuance of new securities. By the Spring of 1988, however, MCorp's efforts to recapitalize without federal assistance were frustrated, in large part, due to the financial difficulties then being experienced by several other major Texas banks.

16. As a consequence, MCorp approached the Federal Deposit Insurance Corporation (the "FDIC") concerning a federal assistance package. Throughout the Summer of 1988, MCorp attempted in vain to conduct substantive negotiations with the FDIC concerning a global recapitalization of the MBanks that would include FDIC assistance.

17. On October 7, 1988, in furtherance of its discussions with the FDIC concerning a recapitalization plan, MCorp made a formal request to the FDIC for open bank assistance for the MBanks (the "MCorp Assistance Plan"). The MCorp Assistance Plan provided for, among other things, the infusion into the MBanks of MCorp's existing liquid assets and FDIC assistance to the MBanks, along with substantial private investment in MCorp to recapitalize the holding companies.

The Board's Regulatory Actions

18. Despite continuous discussions with the Board and the FDIC regarding an overall resolution of MCorp's problems, and without any prior notice to MCorp, on October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp. These administrative actions prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets, other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988. Copies of the First Notice of Charges and the Initial Temporary Orders are annexed hereto as Exhibits A and B, respectively.

19. According to the First Notice of Charges:

> MCorp and its management have engaged, are engaging, and unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.

First Notice of Charges at ¶ 6. Such allegations and the Initial Temporary Orders based thereon were wholly without any factual or legal basis, in that not only had MCorp not taken any action which reasonably could lead the Board to believe that MCorp intended to dissipate its assets, but it had made substantial efforts and was planning to take additional steps to conserve its assets and it had so advised the Board.

20. On October 24, 1988, MCorp publicly announced a moratorium, effective as of October 21, 1988, on the payment of all principal of and interest on all of its approximately $470 million of senior and subordinated debt obligations. It took this step despite the fact that no such action was required by the Initial Temporary Orders or requested pursuant to the First Notice of Charges. By these actions, MCorp sought to preserve its assets for use in connection with a global recapitalization and assistance plan.

21. Although MCorp was in full compliance with the Initial Temporary Orders, late in the afternoon of October 26, 1988 (again without any prior indication to MCorp), the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp. Copies of the Amended Notice of Charges and the Third Temporary Order issued pursuant thereto are annexed hereto as Exhibits

C and D, respectively.[1] The Amended Notice of Charges sought, among other things, to require MCorp to "implement an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

22. Pending the outcome of the administrative proceedings contemplated by the Amended Notice of Charges, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1. These actions were coordinated with the issuance on October 27, 1988 of certain notices of intent by the Comptroller of the Currency of the United States of America (the "Comptroller") to issue capital directives to require eighteen of the MBanks to achieve a minimum level of primary capital.

23. At the time that the October Notices of Charges and the Temporary Orders were issued, the Board knew that MCorp's available liquid assets were approximately $250 million and that the need of the MBanks for additional capital and financial assistance was substantially in excess of available resources, thus making any capital infusion into the MBanks of MCorp's liquid assets, without additional FDIC assistance, a futile gesture by MCorp and a waste of its assets to the detriment of MCorp's creditors and stockholders. In view of such facts, the Board's actions suggest that the Board would

[1] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

not consider fairly the interests of the Debtors' creditors and stockholders in any administrative proceeding.

24. If MCorp had complied with the Third Temporary Order and had downstreamed or contributed its assets to the undercapitalized MBanks, that action would have exposed MCorp and its officers and directors to substantial claims by creditors and stockholders for fraudulent conveyances, corporate waste and mismanagement and MCorp had so previously advised the Board.

25. On November 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking a preliminary injunction suspending or setting aside the Temporary Orders on the grounds that, *inter alia*, (a) the Temporary Orders were invalid and without basis in law or fact, (b) the pendency of the Temporary Orders was damaging both the prospects for a federally assisted recapitalization plan for the MBanks and public confidence in MCorp and the MBanks and (c) if the transfers contemplated by the Third Temporary Order were made it would be a violation of MCorp's fiduciary, statutory and contractual duty to its stockholders and creditors. A copy of MCorp's Amended Complaint and Application for Injunction is annexed hereto as Exhibit E. By order dated March 7, 1989, the District Court that the action commenced by the Amended Complaint be stayed until May 2, 1989, without prejudice to either party.

26. After extended negotiations, which started on October 27, 1988 and continued over the weekend of November 5, 1988, MCorp and all of the federal regulators, including the Board, reached a standstill agreement, the terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). A copy of the Standstill Agreement is annexed hereto as Exhibit F. Among other things, pursuant to the Standstill Agreement, the FDIC

agreed to commence, at once, negotiations with MCorp concerning the MCorp Assistance Plan, while at the same time proposals would be solicited by the FDIC over a ten-week period from third parties for recapitalization of MCorp and assistance for the MBanks. As part of the Standstill Agreement, MCorp agreed to use all reasonable efforts to (a) assure that traditional inter-bank funding relationships of the MBanks were maintained, (b) refrain from filing a voluntary bankruptcy petition and prevent the commencement of an involuntary bankruptcy case and (c) cooperate with the FDIC's solicitation of third-party proposals.

27. In conjunction with the Standstill Agreement, on November 7, 1988, the Board agreed to (a) defer the time for submission of the report of capital injections required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and Third Temporary Order for thirty days from their scheduled dates, and (c) extend the time to file an answer to the First Notice of Charges to November 11, 1988 (the "Standstill Letter"). A copy of the Standstill Letter is annexed hereto as Exhibit G.

28. Over the course of the next ten weeks and, indeed, through the date hereof, MCorp cooperated with the federal regulators and fulfilled its obligations on a timely basis under the Standstill Agreement.

The Seizing of the Banks

29. In contrast to MCorp's conscientious compliance with the letter and spirit of the Standstill Agreement and despite the FDIC's commitment to negotiate in good faith with MCorp, the FDIC never entered into or conducted substantive negotiations with MCorp or attempted in good faith to develop or discuss with MCorp a recapitalization and assistance transaction.

30. Forty-eight hours after MCorp provided notice of the Involuntary Petition to the federal regulators, and in disregard of the Standstill Agreement, late in the evening of March 28, 1989, and early in the morning of March 29, the Comptroller issued *ex parte* orders declaring insolvent twenty of the twenty-five MBanks, including MBank Dallas, N.A. ("MBank Dallas") and MBank Houston, N.A. ("MBank Houston"), and appointing the FDIC as receiver for such MBanks. Thereafter, the FDIC obtained *ex parte* orders from United States District Courts in all Texas districts approving the transfer of certain deposits and other liabilities, and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity wholly owned by the FDIC.

31. MCorp and MCorp Financial have filed an action against the Comptroller and the FDIC in United States District Court for the Northern District of Texas, Dallas Division, asserting, among other things, that the FDIC and the Comptroller, in seizing at least twelve solvent MBanks, exceeded their statutory authority and wrongfully deprived MCorp and MCorp Financial of their property without just compensation. A copy of the First Amended Complaint in that action is annexed hereto as Exhibit H.

32. Following these precipitous events, MCorp was left with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million and other banking and non-banking assets around which to reorganize.

The March Notice of Charges and the MNet Transaction

33. Within one day after the Comptroller seized the twenty MBanks, the Board commenced, by a notice of charges dated March 30, 1989 (the "March Notice of Charges"), administrative proceedings against MCorp

Management and its indirect parent, MCorp. A copy of the March Notice of Charges is annexed hereto as Exhibit I. Despite the seizing by the Comptroller and the FDIC of MBank Houston and MBank Dallas, the March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, *will continue* to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that Corp and MCorp Management allegedly caused MBank Houston and MBank Dallas to provide MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5. Moreover, the March Notice of Charges alleges that MCorp and MCorp Management

> have engaged, are engaging and, unless restrained, *will continue* to engage in unsafe and unsound practices in that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit . . ., (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

March Notice of Charges at ¶ 6 (emphasis supplied). The March Notice of Charges does not specify the relief the Board is seeking, but states only that the Board will seek the entry of "an appropriate order . . . requiring MCorp and MCorp Management to cease and desist from the practices and violations specified [therein] or to take such affirmative action as may be appropriate under the circumstances of this matter." March Notice of Charges

at ¶ 9. In their Answer to the March Notice of Charges, dated April 19, 1989, MCorp and MCorp Management challenge the authority of the Board to bring such actions and dispute the Board's characterizations of the relevant transactions as "extensions of credit" in violation of section 23A of the Federal Reserve Act. A copy of the Answer of MCorp and MCorp Management to the March Notice of Charges is annexed hereto as Exhibit J. Moreover, MCorp and MCorp Management deny that MCorp Management is in arrears on any obligation it may have to the FDIC in its capacity as receiver of Bank Dallas and MBank Houston or to the DIBB, as transferee from the receivership estates of MBank Dallas and MBank Houston of any such claims against MCorp Management. In fact, MCorp and MCorp Management believe that MCorp Management owes nothing to such MBanks because of the offsetting of the balances owing by such former MBanks to MCorp Management.

34. The alleged "unsecured extensions of credit" and "unsafe and unsound practices" in the March Notice of Charges relate to a transaction—the "MNet Transaction"—which occurred more than two years ago. Prior to the MNet Transaction, on August 1, 1985, MBank Houston and MBank Preston, N.A. ("MBank Preston"), which subsequently was merged into MBank Dallas, sold certain assets of their credit card operations to MBank USA, a wholly owned subsidiary of MNet Corp ("MNet") which, in turn, was a wholly owned subsidiary of MCorp Financial. In connection with the sale of their credit card operations, and to fund the ongoing operations of MBank USA, MBank Houston and MBank Preston sold federal funds in the approximate aggregate amount of $364 million to MBank USA "until further notice" [2] pursuant to letter agreements dated August 1,

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[2] Banks routinely buy and sell federal funds. In an "until further notice" federal funds transaction, the selling bank typically agrees to transfer to the buying bank a specified amount of federal

1985 and October 1, 1985 (collectively, the "Letter Agreements"), copies of which are annexed hereto as Exhibits K and L, respectively. In exchange for the use of such funds, MBank USA agreed to (a) repay the principal amount of and interest due on such federal funds upon receipt of demand and (b) pay as "Additional Contingent Fees" the lesser of a specified sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of (i) payment of a specified amount to each particular bank or (ii) December 31, 1993. According to the terms of the Letter Agreements, MBank USA's obligation to pay Additional Contingent Fees survived the termination of the sale of federal funds and the repayment of principal and interest relating thereto.

35. Thereafter, in the MNet Transaction, MCorp Financial sold the capital stock of MNet to Lomas & Nettleton Financial Corporation ("L&N") in exchange for cash, promissory notes issued by L&N (the "L&N Notes"), Series B Preferred Stock of L&N the "L&N Preferred Stock") and common stock of L&N, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. In connection with such sale, MBank Houston and MBank Preston agreed to (a) terminate their respective federal funds transactions with MBank USA upon full repayment to them of the principal and accrued interest owed and (b) release MBank USA from its obligations to pay the Additional Contingent Fees. In consideration therefor, MBank Houston and MBank Preston requested a substitute contingent arrangement to compensate them for the Additional Contijngent Fees to which they originally were entitled.

36. To facilitate the sale of MNet to L&N and as a substitute contingent payment arrangement, MCorp Management agreed to pay MBank Houston and MBank Preston an aggregate amount equal to the lesser of (a)

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funds and, in exchange, the buying bank agrees to pay the selling bank interest at the Federal Funds rate and to re-transfer the federal funds upon demand.

the sum of the interest actually received by MCorp Management on the L&N Note and the dividends actually received by MCorp Management on the L&N Preferred Stock or (b) quarterly cash payments of $2,853,000 (the "Contingent Payments"). Like MBank USA's obligation to pay the Additional Contingent Fees for which the Contingent Payments were intended as a substitute, MCorp Management's obligation to make the Contingent Payments terminated on the earlier of payment in full of the amount of Additional Contingent Fees then due or December 31, 1993. Copies of the Agreements, each dated as of December 30, 1986, which embody the releases by MBank Houston and MBank Preston of MBank USA and the substitution of the Contingent Payments, are annexed hereto as Exhibits M and N, respectively.

37. In the March Notice of Charges, the Board attempts to characterize MCorp Management's obligation to make the Contingent Payments alternatively as "unsecured extensions of credit" to MCorp Management by MBank Preston and MBank Houston (March Notice of Charges at ¶ 5(b)(1)) or as a repayment of "unsecured extensions of credit" (March Notice of Charges at ¶ 5(a)(1)). There is no basis in law or fact to characterize the Contingent Payments as extensions of credit for at least two independent reasons. First, the Contingent Payments merely represent an override on amounts that MCorp Management may or may not receive as interest and dividends on the L&N Notes and L&N Preferred Stock, with a defined maximum amount of $2,583,000 quarterly. Second, the Contingent Payments cannot be considered "extensions of credit" because no funds or other property of MBank Houston and MBank Preston were ever received by MCorp Management in exchange or consideration for the Contingent Payments. All general indicia of an "extension of credit," such as the commitment of the assets of the party extending credit, the presence of consideration to

the creditor for the extension, a date certain for payment and a fixed unconditional obligation to repay any sums committed, are absent from the agreements with MCorp Management pursuant to which the Contingent Payments are to be made.

The Board's Continued Prosecution of the Administrative Proceedings Is Not Appropriate in the Context of the Debtors' Chapter 11 Cases

38. The pendency of the Debtors' chapter 11 cases renders the October Notices of Charges and the Temporary Orders moot for the following reasons:

(a) By virtue of the filing of the Chapter 11 cases and pursuant to the provisions of chapter 11 of the Bankruptcy Code, the Debtors may not pay dividends to the holders of MCorp's common or preferred stock.

(b) Under no circumstances may the Debtors dissipate or transfer their assets or make any payments with respect to prepetition claims except pursuant to an order of this Court or a confirmed chapter 11 plan.

(c) The actions of the Comptroller in declaring twenty MBanks insolvent and placing them in the hands of the FDIC renders the balance of the charges in the October Notices of Charges and the Temporary Orders moot because the remaining MBanks have not been determined to be in need of an infusion of capital.

39. Continued prosecution of the October Notices of Charges or enforcement of the Temporary Orders would constitute a blatant attempt by the Board to exert control over the Debtors' assets, in the face of this Court's exclusive jurisdiction over the Debtors' property, wherever located, and in derogation of the rights, claims and interests of the creditors and stockholders of the Debtors and, therefore, should not be permitted.

40. The March Notice of Charges is moot in view of the fact that whatever MCorp and MCorp Management did occurred before the commencement of these chapter 11 cases and relates to banks closed by the Comptroller, over which the Debtors no longer have any control.

41. Moreover, the administrative proceeding initiated by the March Notice of Charges is not an action in furtherance of the Board's regulatory functions. Indeed, as MCorp and MCorp Management allege in their Answer to the March Notice of Charges, the Board has no statutory authority to bring an action against MCorp and MCorp Management under section 23A of the Federal Reserve Act and exceeded its authority under 12 U.S.C. § 1818(b). In any event, any cease and desist order which might result would necessarily be meaningless because the only MBanks involved are no longer under MCorp's control. Rather, the March Notice of Charges constitutes an attempt by the Board to bolster the alleged claims against the Debtors held either by the FDIC, as receiver for MBank Houston and MBank Dallas or by the DIBB.

42. In essence, the March Notice of Charges involves, at most, a "garden variety" commercial dispute with a chapter 11 debtor over whether certain prepetition claims asserted by the Board (for the apparent benefit of the FDIC) should be allowed. The Board, if permitted to proceed, will be directly adjudicating the validity of a prepetition claim and the exercise of a prepetition offset. Such determinations clearly fall within the province and jurisdiction of this Court under 28 U.S.C. § 1334(b), not in the regulatory administrative tribunal. To the extent that the Board, via administrative proceedings, seeks something more than a determination of the FDIC's claim, the proceeding is an effort to harass the Debtors and embarass this Court and its exclusive jurisdiction over the property of these Debtors under 28 U.S.C. § 1334(d).

FIRST CAUSE OF ACTION
(JUDGMENT DECLARING THAT PURSUANT TO 11 U.S.C. § 362(a) THE BOARD IS STAYED FROM PROSECUTING THE OCTOBER NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS)

43. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 42 as if fully set forth herein.

44. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief operates as a stay, applicable to all entities, including government agencies, of any act to obtain possession of property of the Debtors' estates or of property from the estates or to exercise control over property of the estate. Continued prosecution of the October Notices of Charges and enforcement of the Temporary Orders, even though the issues raised by them are moot, would constitute an attempt to exert direct control over property of the Debtors' estates in violation of section 362(a). Furthermore, since the charges made in the October Notices of Charges do not involve the public health, safety or morals, there is no exception from the automatic stay under section 362(b) for such acts.

45. Accordingly, the Debtors are entitled to a judgment declaring that the administrative proceedings commenced by the October Notices of Charges Notices of Charges are subject to the automatic stay under section 362 of the Bankruptcy Code and restraining and enjoining the Board from (a) prosecuting the October Notices of Charges and (b) enforcing the Temporary Orders.

SECOND CAUSE OF ACTION (INJUNCTION PURSUANT TO 11 U.S.C. § 105 ENJOINING THE BOARD FROM PROSECUTING THE OCTOBER NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS)

46. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 45 as if fully set forth herein.

47. Pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Bankruptcy Rules 7001 and 7065, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including an injunction necessary to preserve or protect the Debtors and their estates for the benefit of their creditors and stockholders, to protect the exclusive jurisdiction of this Court over the Debtors and their assets wherever located, and to insure that the provisions of the Bankruptcy Code are carried out.

48. The October Notices of Charges and the Temporary Orders seek to compel the Debtors to take or refrain from taking actions which pursuant to the Bankruptcy Code they are already prohibited from taking without this Court's prior approval or pursuant to a confirmed chapter 11 plan. Moreover, the October Notices of Charges and the Temporary Orders seek to compel the Debtors to contribute assets to MBanks which are no longer under the direct or indirect control of MCorp. Thus, the relief sought by the Board pursuant to the October Notices of Charges and the Temporary Orders is moot in view of the pending Chapter 11 cases.

49. If the Board is permitted to pursue administrative proceedings to wrest control of the Debtors' assets from *custodia legis*, the Debtors will have been stripped of substantial liquid assets that would form an integral part of any chapter 11 plan without the due process protections, including notice and an opportunity to be heard, afforded the Debtors and their creditors, stockholders and other parties in interest by the Bankruptcy Code. The continuation of such administrative proceedings will also divert the time and energies of the Debtors' personnel and professionals from their primary taks of pursuing the rehabilitation of the Debtors and the formulation of reorganization plans for the Debtors and the expenses incurred to defend such administrative proceedings will be an unnecessary and wasteful financial drain on those

Debtors' estates. At the very outset of their chapter 11 cases, the Debtors' efforts to reorganize would be crippled. The foregoing averments amply demonstrate the substantial and irreparable injury and prejudice that the Debtors and their estates and creditors will suffer unless the Board is restrained from prosecuting the October Notices of Charges, enforcing the Temporary Orders or taking any other administrative action seeking to control property of the Debtors' estates.

50. Accordingly, the Debtors are entitled to the issuance of an injunction pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65 enjoining and restraining the Board from (a) prosecuting the October Notices of Charges, (b) enforcing the Temporary Orders and (c) otherwise commencing a proceeding or action to obtain a cease and desist order or other relief against any of the Debtors or property of the Debtors' estates without prior approval of the Court after notice and a hearing.

THIRD CAUSE OF ACTION (JUDGMENT DECLARING THAT PURSUANT TO 11 U.S.C. § 362 THE BOARD IS STAYED FROM PROSECUTING THE MARCH NOTICE OF CHARGES)

51. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 50 as if fully set forth herein.

52. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief under the Bankruptcy Code operates as a stay, applicable to all entities, against the commencement or continuation of any judicial or administrative action against the debtor that was or could have been commenced before the commencement of the bankruptcy case or to recover a claim against the debtor that arose before the commencement of the case and of any act to obtain possession of property of the debtor's estate or of property from the estate or to exercise control over the debtor's property.

53. The commencement of the administrative proceedings pursuant to the March Notice of Charges is an administrative action which could have been commenced prepetition and relates solely to alleged prepetition conduct and actions of MCorp and MCorp Management and, thus, violates the automatic stay pursuant to section 362(a) of the Bankruptcy Code.

54. Section 362(b) of the Bankruptcy Code does not exempt the Board's administrative proceedings pursuant to the March Notice of Charges from the automatic stay because such proceedings are not actions to enforce the type of police or regulatory power exempted by section 362(b). Rather, such administrative proceedings constitute an attempt by the Board to establish and support alleged prepetition claims now held either by the FDIC as receiver for MBank Dallas and MBank Houston or the DIBB and, carried to their logical conclusion, an attempt by the Board to obtain possession of property of the Debtors' estates.

55. Accordingly, the Debtors are entitled to a judgment declaring that the administrative proceedings commenced by the March Notice of Charges are enjoined pursuant to section 362(a) of the Bankruptcy Code and restraining and enjoining the Board from prosecuting the March Notice of Charges.

FOURTH CAUSE OF ACTION (INJUNCTION PURSUANT TO 11 U.S.C. § 105 (a) ENJOINING THE BOARD FROM PROSECUTING THE MARCH NOTICE OF CHARGES)

56. Plaintiffs repeat and reaver the averments set forth in Paragraphs 1 through 55 as if fully set forth herein.

57. As stated, pursuant to section 105(a) and Federal Rules of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Bankruptcy Rules 7001

and 7065, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code.

58. The Debtors submit that the foregoing averments establish that the Debtors, their estates and creditors will suffer substantial and irreparable injury and prejudice unless the Board is enjoined from prosecuting the administrative procedings initiated pursuant to the March Notice of Charges. Permitting the Board to proceed will allow the Board to determine the amount of a claim held by another federal agency or the DIBB resulting in a piecemeal determination of claims in derogation of the procedures and protections established under the Bankruptcy Code. Moreover, defending the administrative proceedings will divert the valuable attention and limited economic, personnel and professional resources from the larger and more important goals of rehabilitating the Debtors and preserving the Debtors' estates for the benefit of all creditors and successfully reorganizing.

59. Accordingly, the Debtors are entitled to the issuance of an injunction pursuant to section 105(a) of the Bankruptcy Code and Federal Rule of Civil Procedure 65 enjoining the Board from continuing to prosecute the March Notice of Charges.

WHEREFORE, the Debtors respectfully request that the Court enter an order and judgment (1)(a) declaring that the administrative proceedings initiated by the Board pursuant to the October Notices of Charges and the March Notice of Charges are subject to the automatic stay extant pursuant to section 362(a) of the Bankruptcy Code and restraining and enjoining the Board from prosecuting such administrative actions and enforcing the Temporary Orders, or, in the alternative, (b) restraining and enjoining the Board from prosecuting the October Notices of Charges and the March Notice of Charges and enforcing the Temporary Orders, pursuant to section 105(a) of the Bankruptcy Code, (2) restraining and enjoining the Board from commencing any further administrative proceedings or action to obtain or enforce a cease and desist order or other relief against any of the Debtors or any property of the Debtors' estates without the prior approval of this Court after notice and a hearing, and (3) granting to the Debtors such other and further relief as may be just and proper under the circumstances.

Dated: Houston, Texas
Dated: May 2, 1989

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC., MCORP MANAGEMENT, AND MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., AND MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

EMERGENCY MOTION PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 65 AND BANKRUPTCY RULE 7065 FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION

TO THE HONORABLE LETITIA Z. CLARK,
UNITED STATES BANKRUPTCY JUDGE:

Plaintiffs MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in possession in these chapter 11 cases (collectively, the "Debtors"),

as and for their Motion for a temporary restraining order and a preliminary injunction against the defendant, the Board of Governors of the Federal Reserve System of the United States of America (the "Board"), pursuant to Federal Rule of Civil Procedure 65, made applicable to this adversary proceeding pursuant to Rules 7001 and 7065 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), respectfully represent:

BACKGROUND

1. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp.

2. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer its chapter 11 case to this Court. By orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Bankruptcy Rule 1015.

3. MCorp and its subsidiaries comprise a banking and financial services enterprise. As of December 31, 1988, MCorp banking subsidiaries had combined assets in excess of approximately $17 billion. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for MCorp Management, the

MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the MBanks and other MCorp subsidiaries.

4. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

The October Notices of Charges

5. On October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp.[1] According to the First Notice of Charges:

> MCorp and its management have engaged, are engaging, and, unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.

First Notice of Charges at ¶ 6. The First Notice of Charges established December 12, 1988 as the date on which a hearing would be held before an administrative law judge designated by the Board to take evidence on the charges and determine "whether requiring MCorp to cease and desist from the unsafe and unsound practices specified [therein] or to take affirmative action to correct the conditions resulting from such unsafe and unsound practices." First Notice of Charges at ¶ 8.

[1] Copies of the relevant documents referred to herein are annexed to the Affidavit of Gene H. Bishop in Support of the Motion dated May 1, 1989 (the "Affidavit"), and are incorporated herein by reference.

6. Pending the completion of the administrative proceedings initiated by the First Notice of Charges, the Initial Temporary Orders prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets, other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988.

7. Although MCorp was in full compliance with the Initial Temporary Orders, on October 26, 1988, the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp.[2] The Amended Notice of Charges sought, among other things, to require MCorp to "implement an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

8. Pending the outcome of the administrative proceedings contemplated by the Amended Notice of Charges, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1.

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[2] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

9. In response to the Temporary Orders, on November 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking a preliminary injunction suspending or setting aside the Temporary Orders on the grounds that the Temporary Orders were without basis in law or fact. Indeed, MCorp alleged that compliance with the Third Temporary Order required it to violate its fiduciary, statutory and contractual duties to its stockholders and creditors. Furthermore, MCorp alleged that the pendency of the Temporary Orders damaged the prospects for a federally assisted recapitalization plan for the MBanks which MCorp was attempting to negotiate with the Federal Deposit Insurance Corporation (the "FDIC") and undermined public confidence in MCorp and the MBanks.

10. After extended negotiations, MCorp and all of the federal banking regulators, including the Board, reached a standstill agreement relating to the recapitalization plan, the terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). In conjunction with the Standstill Agreement, on November 7, 1988, the Board agreed to (a) defer the time for submission of the report of capital injections required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and the Third Temporary Order for thirty days from their scheduled dates ,and (c) extend the time to file an answer to the First Notice of Charges to November 11, 1988.

The Seizure of the MBanks

11. In disregard of the Standstill Agreement, late in the evening of March 28, 1989, and early in the morning of March 29, the Comptroller of the Currency of the United States of America (the "Comptroller"), acting in

concert with the Board and the FDIC, issued *ex parte* orders declaring insolvent twenty of the twenty-five MBanks, including MBank Dallas, N.A. ("MBank Dallas") and MBank Houston, N.A. ("MBank Houston"), and appointing the FDIC as receiver for such MBanks. Thereafter, the FDIC obtained *ex parte* orders from United States District Courts in all four Texas districts approving the transfer of certain deposits and other liabilities and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity that is wholly owned by the FDIC.

12. Following these precipitous events, MCorp was left with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million and other banking and non-banking assets.

13. On March 31, 1989, MCorp and MCorp Financial filed an action against the Comptroller and the FDIC in United States District Court for the Northern District of Texas, Dallas Division, asserting, among other things, that the FDIC and the Comptroller, in seizing at least twelve solvent MBanks, exceeded their statutory authority and wrongfully deprived MCorp and MCorp Financial of their property without just compensation. Pursuant to the First Amended Complaint against the Comptroller and the FDIC filed on April 21, 1989, MCorp and MCorp Financial seek injunctive relief and damages in excess of $70 million.

The March Notice of Charges

14. Within one day after the Comptroller seized the twenty MBanks, the Board commenced, by a notice of charges dated March 30, 1989 (the "March Notice of Charges"), an administrative proceeding against MCorp and MCorp Management. The March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, will continue

to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that MCorp and MCorp Management allegedly caused MBank Houston and MBank Dallas to provide MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5.[3] Moreover, the March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging, and, unless restrained will continue to engage in "unsafe and unsound banking practices" in violation of 12 U.S.C. § 1818(b), in that they failed, and caused MBank Dallas and MBank Houston to fail, to properly account for the alleged "unsecured extensions of credit." March Notice of Charges at ¶ 6. The March Notice of Charges also alleges that "the commencement and continuation of the proceedings against MCorp or MCorp Management instituted by this Notice would be exempt from the automatic stay provisions of the Federal Bankruptcy Code." March Notice of Charges at ¶ 8.

15. By Answer dated April 19, 1989, MCorp and MCorp Management challenge the authority of the Board to bring the administrative proceeding contemplated by the March Notice of Charges and dispute the Board's characterization of the relevant transactions as "extensions of credit" in violation of section 23A of the Federal Reserve Act. Moreover, MCorp and MCorp Management deny that the administrative proceedings initiated by the Board's March Notice of Charges are exempt from the automatic stay or that MCorp Management is in arrears on any obligation it may have to the FDIC in its capacity as receiver of MBank Dallas and MBank Houston or to the DIBB as transferee of any such claims against MCorp Management from the receivership estates of MBank Dallas and MBank Houston. In fact, MCorp and MCorp Management believe that MCorp Management owes nothing to such MBanks because of the offsetting balances

[3] The transactions underlying the alleged "unsecured extensions of credit" are described in detail in the Affidavit.

owing by such former MBanks to MCorp Management. The hearing in respect of the March Notice of Charges before an administrative law judge designated by the Board has been set for May 29, 1989, unless stayed by this Court.

The Adversary Proceeding

16. Pursuant to the Complaint initiating the above-captioned adversary proceeding (the "Complaint"), the Debtors seek the entry of an order and judgment (1) (a) declaring that prosecution of the October and March Notices of Charges (collectively, the "Notices of Charges") and enforcement of the Temporary Orders are stayed pursuant to the automatic stay extant under section 362 (a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining and restraining the Board from continuing to prosecute the Notices of Charges or enforce the Temporary Orders pursuant to section 105(a) of the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court granted after notice to the Debtors and a hearing.

17. Under section 362(a) of the Bankruptcy Code, the filing of a petition for relief under the Bankruptcy Code operates as a stay, applicable to all entities, against the commencement or continuation of any judicial or administrative action against the debtor that was or could have been commenced before the commencement of the bankruptcy case or to recover a claim against the debtor that arose before the commencement of the case and of any act to obtain possession of property of the debtor's estate or of property from the estate or to exercise control over the debtor's property.

18. The October Notices of Charges and the Temporary Orders require MCorp to marshal all of its assets and seek to force MCorp to contribute substantially all

of its liquid asets to the MBanks. The March Notice of Charges, in substance, seeks to determine and recover a prepetition claim now held by the FDIC, as receiver for MBank Dallas and MBank Houston, or by the DIBB, as transferee of the alleged claims from the receivership estates of MBank Dallas and MBank Houston. Accordingly, continued prosecution of the Notices of Charges by the Board clearly violates the automatic stay under section 362(a). Furthermore, because the Notices of Charges do not in any manner implicate the public health, safety, welfare or morals, the Board's actions are not entitled to the benefits of the limited exceptions from the automatic stay under section 362(b).

19. Pursuant to section 105(a) of the Bankruptcy Code, this Court may issue any order that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including an injunction necessary to preserve or protect the Debtors and their estates for the benefit of their creditors and stockholders, to protect the exclusive jurisdiction of this Court over the Debtors and their assets, and to insure that the provisions of the Bankruptcy Code are carried out. Under the circumstances of this case as set forth in more detail in the Affidavit and the Memorandum of Law in support of the Motion (the "Memorandum of Law") continued prosecution of the Notices of Charges or enforcement of the Temporary Orders would constitute a blatant attempt by the Board to exert direct control over the Debtors' assets, in the face of this Court's exclusive jurisdiction over such assets and in derogation of the rights, claims and interests of the Debtors and their creditors and stockholders. Thus, even in the absence of the automatic stay, an injunction under section 105(a) is clearly warranted.

PENDING JUDGMENT IN THIS ADVERSARY PROCEEDING THE BOARD SHOULD BE ENJOINED FROM PROSECUTING THE NOTICES OF CHARGES AND ENFORCING THE TEMPORARY ORDERS

20. Federal Rule of Civil Procedure 65, made applicable to this adversary procedeing pursuant to Bankruptcy Rules 7001 and 7065, authorizes this Court to issue temporary restraining orders and preliminary injunctions. The requirements for the issuance of a temporary restraining order and preliminary injunction are as follows:

(1) plaintiff has established a substantial likelihood of success on the merits;

(2) a substantial threat exists that plaintiff will suffer an irreparable injury if the injunction is not granted;

(3) the threatened injury to the plaintiff outweighs the threatened harm that the injunction will cause the defendant; and

(4) the granting of the injunction will not be adverse to the public interest.

21. As set forth in more detail in the Affidavit and the Memorandum of Law, the Debtors submit that there is more than a substantial likelihood that they will succeed on the merits of the Complaint. The Notices of Charges and the Temporary Orders relate to prepetition conduct which is clearly stayed pursuant to section 362(a) and do not fall within the exceptions enumerated in section 362(b). Furthermore, the Board's administrative actions constitute an imminent threat to the Debtors' assets and reorganization efforts which clearly warrants the issuance of a permanent injunction pursuant to section 105(a).

22. Pending a determination of the Complaint, compliance with the Board's directives and continued prosecution of the administrative proceedings would cause irreparable injury to the Debtors and their creditors and stockholders for at least two independent reasons. First, preparing for and defending such administrative actions would unduly burden the Debtors' limited economic and human resources. Second, such actions threaten this Court's exclusive authority to administer these chapter 11 cases for the benefit of all of the Debtors' creditors, stockholders and other parties in interest in accordance with the provisions of the Bankruptcy Code.

23. In the absence of a stay of the administrative proceedings commenced pursuant to the March Notice of Charges, the Debtors' management personnel will be forced to direct their attention over the next four weeks almost exclusively to the preparation for the hearing scheduled for May 29, 1989 and to divert their attention from efforts to stabilize and, ultimately, reorganize the Debtors and their businesses. Preparation of a vigorous defense of the March Notice of Charges would require a substantial commitment of time and effort by the Debtors' employees. As described in the Affidavit, the transactions underlying the March administrative charges relating to MBank Dallas and MBank Houston began more than two years ago and the accounting for, and the compiling of information in respect of, such transactions and the offsetting balances will be complex, time-consuming and arduous.

24. The inherent burden of such tasks is, however, increased exponentially in the case of the Debtors. The seizure of the MBanks decimated the Debtors' accounting personnel who were, for the most part, employees of the former MBanks which were seized by the Comptroller and who now work for the DIBB. Thus, the preparation of an effective and vigorous defense to the March Notice of Charges will severely burden the Debtors' few remaining management level employees. Similarly, defending the October Notices of Charges or the Temporary Orders, if the Board seeks to revive them,

will require an equally burdensome commitment of time and effort by such employees. In view of the essentially moot nature of the Board's administrative proceedings, a more wasteful use of the Debtors' limited resources can hardly be imagined.

25. At this critical early stage of these chapter 11 cases, it is absolutely essential to the Debtors' reorganization efforts that their limited resources be focused on the larger and more important goals of stabilizing and rehabilitating the Debtors' remaining businesses. The seizure of the MBanks and their employees required the Debtors' remaining personnel to assume substantially more responsibility for the operations of the Debtors' remaining businesses. Simultaneously, as a consequence of the filing of the chapter 11 cases, the Debtors' personnel has had to focus their immediate attention on compiling and assembling the voluminous information required to be filed at the initial stages of the chapter 11 cases, preparing and filing the typical pleadings necessary to the administration of the chapter 11 cases and responding to and communicating with the United States Trustee, creditors, stockholders and other parties in interest. Unless the Board is enjoined from proceeding, preparing for and defending the Board's administrative actions would unnecessarily divert substantial attention and resources from these activities and derail the Debtors' efforts to develop a business plan and propose a plan or plans of reorganization during the exclusive period.

26. In addition to burdening the Debtors' estates, continued prosecution of the Notices of Charges threatens to disrupt this Court's effective administration of the Debtors' chapter 11 cases. The essence of the May 29 hearing is the determination of a prepetition claim against the Debtors' estates. The determination of such claims against the Debtors' estates is, however, one of the essential functions of this Court and should not be interfered with in any way by any other tribunal. Yet,

even in the face of the Debtors' chapter 11 cases, the Board gives no justification for bringing its administration proceeding. Unless restrained, the Board's actions would frustrate the Court's ability to orderly and consistently administer these estates for the benefit of all of the Debtors' constituents.

27. Further, if the Board is permitted to proceed, it would wrest from *custodia legis* control of the very assets which would form the basis of any plan of reorganization for the Debtors. Through its administrative proceedings, the Board would accomplish this result without the due process protections, including notice and an opportunity to be heard, afforded the Debtors' creditors, stockholders and other parties in interest by the Bankruptcy Code. Under the Notices of Charges, the Board's claims against the Debtors will be determined in a private hearing before an administrative law judge of the Board's own choice. Based upon the administrative law judge's recommendations, the Board will then issue "an appropriate order" and its determination will be subject to review only upon appeal to a circuit court of appeals under the "arbitrary and capricious" standard except in extraordinary circumstances. In view of the Board's past actions detailed in the Affidavit, it is unlikely that the interests of the Debtors' creditors, stockholders and other parties in interest will in any way be protected in such administrative proceedings.

28. The Debtors submit that the foregoing amply demonstrates that the Debtors, their estates and creditors will suffer substantial and irreparable injury and prejudice unless the Board is enjoined from prosecuting the Notices of Charges and enforcing the Temporary Orders pending a resolution of the Complaint.

29. Conversely, there will be no harm or prejudice to the Board if its administative actions are stayed. The Notices of Charges relate principally to former MBanks which are no longer under the control of the Debtors and the Board makes no asertion that the alleged violations

affect the Remaining MBanks. Thus, continued prosecution of the Notices of Charges is largely irrelevant, and serves no regulatory purpose or public interest.

30. As detailed in the Affidavit, the only purpose served by continued prosecution of such administrative actions is to harass the Debtors and protect the pecuniary interests of the FDIC or the DIBB. At the very least, there is no urgency to such proceedings. Indeed, the appropriate procedure for asserting the pecuniary interest of the FDIC or the DIBB is the filing by the FDIC or the DIBB of a proof of claim against the Debtors. Thus, the Debtors submit that any harm to the Board in restraining it from prosecuting its administrative proceedings pales in comparison to the substantial harm to the Debtors and their creditors and stockholders described above. Accordingly, a balancing of the relative harm to the parties clearly favors the issuance of a temporary restraining order and preliminary injunction against the Board.

31. As clearly evidenced by congressional policy, the public interest in this case lies in promoting a successful reorganization of the Debtors. If the Board is permitted to proceed, however, any hope for a successful reorganization will be jeopardized and may even be destroyed at the very outset of the Debtors' chapter 11 cases. The Board's administrative proceedings seek to usurp this Court's control over the Debtors' assets and distribute them in accordance with its own agenda to the detriment of the Debtors' creditors and stockholders whose interests the Bankruptcy Code is intended to protect.

32. Accordingly, the Debtors submit that the facts and circumstances of the instant case clearly warrant the issuance of a temporary restraining order and preliminary injunction restraining and enjoining the Board from prosecuting the Notices of Charges, enforcing the Temporary Orders or initiating any further administrative proceedings against the Debtors without the prior approval of this Court granted after notice to the Debtors and a hearing.

33. No previous application for the relief sought herein has been made to this or to any other Court.

WHEREFORE, the Debtors respectfully request that the Court enter the proposed temporary restraining order, a copy of which is annexed hereto as Exhibit A.

Dated: Houston, Texas
May 2, 1989

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos.
89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC, ETC.,
MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and MCORP
MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: May 2, 1989]

AFFIDAVIT OF GENE H. BISHOP IN SUPPORT OF EMERGENCY MOTION FOR TEMPORARY RESTRAINING ORDER AND PRELIMINARY INJUNCTION

STATE OF TEXAS)
) ss.:
COUNTY OF DALLAS)

GENE H. BISHOP, being duly sworn, deposes and says:

1. I am the Chairman of the Board and Chief Executive Officer of MCorp and MCorp Management and make this affidavit in support of the emergency motion (the "Motion") of MCorp, MCorp Financial, Inc. ("MCorp Financial") and MCorp Management, debtors in posses-

sion and the above-named plaintiffs (collectively, the "Debtors"), for a temporary restraining order and a preliminary injunction against the Board of Governors of the Federal Reserve System of the United States of America (the "Board"). Except as to those matters stated upon information and belief, I have personal knowledge of the facts set forth herein.

2. Pursuant to the Complaint in the above-captioned adversary proceeding (the "Complaint") and the Motion, the Debtors seeks to restrain and enjoin the Board from prosecuting two separate administrative proceedings initiated by the Board. The first set of administrative proceedings was initiated by the Board in October 1988 and seeks to compel MCorp to infuse all of its available liquid assets into its MBank subsidiaries most of which are no longer under the control of MCorp. The Board's second round of administrative proceedings, initiated in March 1989 after the commencement of MCorp's bankruptcy case, seeks to determine and recover certain alleged pre-petition claims against MCorp Management held by the Federal Deposit Insurance Corporation (the "FDIC") as receiver of two of MCorp's former MBank subsidiaries. As set forth below, the Debtors submit that such administrative proceedings are subject to the automatic stay under 11 U.S.C. § 362(a) and, in any event, are moot, largely irrelevant to the Debtors' chapter 11 cases and unduly burdensome and, accordingly, should be stayed.

Commencement of the Chapter 11 Cases

3. On March 21, 1989, three creditors of MCorp commenced an involuntary case under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code") against MCorp (the "Involuntary Petition") in the United States Bankruptcy Court for the Southern District of New York (the "New York Bankruptcy Court"). On March 31, 1989, MCorp Financial and MCorp Management each filed with this Court a voluntary petition

for relief under chapter 11 of the Bankruptcy Code. Later that day, upon application of MCorp, the New York Bankruptcy Court ordered the case commenced by the Involuntary Petition converted to a case under chapter 11 pursuant to section 706(a) of the Bankruptcy Code and entered an order for relief under chapter 11 upon consent of MCorp. Each of the Debtors is operating its business and managing its properties pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

4. By order dated April 4, 1989, the New York Bankruptcy Court granted MCorp's motion to transfer venue of its chapter 11 case to this Court and, by orders dated March 31, 1989 and April 20, 1989, the chapter 11 cases of MCorp, MCorp Financial and MCorp Management are being jointly administered in accordance with Rule 1015 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

Summary of Relief Requested

5. The filing of the Involuntary Petition and the consequent filing of the voluntary petitions of MCorp Financial and MCorp Management followed a lengthy period during which the FDIC refused to seriously consider a global recapitalization of MCorp and its MBank subsidiaries which MCorp informally proposed to the FDIC in late summer 1988 and formally presented to the FDIC on October 7, 1988 (the "MCorp Assistance Plan"). As detailed below, the Debtors believe that the FDIC's persistent refusal to consider the MCorp Assistance Plan was part of a larger plan of the federal banking regulators to delay FDIC assistance for the MBanks until MCorp contributed all of its liquid assets to the MBanks as additional capital and, then, when a sufficient number of the MBanks were facing liquidity crises or could be made to appear insolvent, the Comptroller of the Currency of the United States of America (the "Comptroller") could seize and transfer their assets to the

FDIC to the detriment of the Debtors' creditors and stockholders.

6. The Board, acting in concert with the Comptroller and the FDIC, played an integral part in this plan. After MCorp refused to downstream its assets to the MBanks except as part of a global recapitalization of the MBanks, in October 1988, the Board initiated administrative proceedings and issued three orders which, taken together, directed MCorp to marshall all of its available assets and transfer them to certain MBanks as capital contributions, without any assurance of FDIC assistance. When MCorp again refused to downstream its assets without the FDIC assistance needed to save the MBanks, the regulators embarked on a campaign of delay that ultimately led to the filing of the Involuntary Petition.

7. Two business days after MCorp learned and notified the regulators of the filing of the Involuntary Petition, on March 28, 1989 the federal regulators carried out their plan and seized twenty of the twenty-five MBanks. Again, the Board played a pivotal role. The Board improperly demanded repayment by MBank Dallas, N.A. ("MBank Dallas") of its substantial borrowings from the Federal Reserve Bank of Dallas. This action had a domino effect rendering at least twelve solvent MBanks allegedly "insolvent."

8. Despite the Debtors' chapter 11 cases, the Board's October administrative proceedings are pending and may be utilized by the Board to obtain leverage over the Debtors in these chapter 11 cases. Indeed, as if to demonstrate its resolve in this regard, within two days after the Comptroller and the FDIC seized the twenty MBanks, the Board initiated another administrative proceeding in March 1989, in essence seeking to recover alleged prepetition claims against the Debtors which are now property of the FDIC, as receiver for two of the seized MBanks. As set forth below, such actions appear calculated only to harass the Debtors.

9. Pursuant to the Complaint, the Debtors seek a permanent injunction to prevent the Board from continuing to prosecute its administrative proceedings. In view of the pendency of the Debtors' chapter 11 cases and the seizure of twenty of the MBanks, such proceedings are moot. Moreover, continued prosecution would further deplete the Debtors' assets, impose substantial burdens on the Debtors and their limited personnel and resources, and otherwise prejudice the legitimate interests of the Debtors' creditors and stockholders, all in contravention of the policies and provisions of the Bankruptcy Code. Specifically, the Complaint seeks a judgment (1)(a) declaring that such administrative proceedings are stayed pursuant to the automatic stay extant under section 362(a) of the Bankruptcy Code or, in the alternative, (b) permanently enjoining the Board from continuing to prosecute such administrative proceedings pursuant to section 105(a) of the Bankruptcy Code, and (2) permanently enjoining and restraining the Board from commencing any further administrative proceedings against the Debtors except with the prior approval of the Court after notice to the Debtors and a hearing. The Motion seeks the entry of a temporary restraining order and preliminary injunction enjoining the Board from taking such actions pending a determination of the Complaint.

Background of the Debtors

10. Prior to the seizure of the MBanks by the federal banking regulators, MCorp and its subsidiaries comprised a banking and financial services enterprise, which, among other things, owned and operated twenty-five MBanks with approximately 85 branch offices serving approximately 33 communities in the State of Texas. As of December 31, 1988, the MCorp banking subsidiaries had combined assets totalling more than $17 billion.

11. MCorp is a holding company principally for MCorp Financial which, in turn, is the holding company for

MCorp Management, the remaining MBanks and substantially all of MCorp's other non-debtor subsidiaries. MCorp Management provides management and technical services for the remaining MBanks and other MCorp subsidiaries.

12. MCorp is a Delaware corporation whose securities are listed and traded on the New York Stock Exchange. As of January 31, 1989, MCorp had outstanding 42,565,012 shares of common stock held by 14,910 stockholders and 959,670 shares of cumulative convertible preferred stock held by 628 holders. In addition, MCorp has outstanding two series of "Money Market Cumulative Preferred Stock" with an aggregate liquidation preference of $125 million that are not publicly traded. MCorp also has outstanding senior and subordinated public debt in the aggregate unpaid principal amount of approximately $470 million, held by 587 holders of record.

Recapitalization Efforts

13. To reverse the effects of the prolonged economic recession of the State of Texas, beginning in the Fall of 1987 MCorp attempted to recapitalize, without federal assistance, through the sale of assets and the issuance of new securities. By the Spring of 1988, however, MCorp's efforts to recapitalize without federal assistance were frustrated. Widespread publicity surrounding the financial difficulties then being experienced by several other major Texas banks led investors to express reservations about recapitalizing MCorp without federal assistance. In view of such investor reaction, MCorp concluded that a private recapitalization plan without federal assistance would not be feasible.

14. As a consequence, MCorp approached the FDIC concerning a federal assistance package. During the Summer of 1988, I and other members of the senior management of the Debtors attempted on numerous occasions to open substantive negotiations with the FDIC on the terms

and conditions of an FDIC assistance package for the MBanks that would include investments by MCorp and third-party investors.

15. L. William Seidman, the Chairman of the FDIC, indicated to me in several meetings his belief that MCorp had done a better job than others in managing the adversities created by the prolonged recession in Texas and was deserving of "help." Seidman further agreed that an early assistance plan would economically benefit the FDIC; however, he did not favor FDIC assistance which could be construed as unduly beneficial to stockholders and creditors of MCorp. Accordingly, the FDIC steadfastly refused to conduct substantive negotiations with MCorp concerning the MCorp Assistance Plan. The FDIC staff explained that the FDIC would not negotiate with MCorp because (a) MCorp was solvent and had several hundred million dollars of liquid assets and (b) the MBanks were neither insolvent nor on the brink of insolvency. Moreover, the FDIC insisted on other conditions to holding negotiations with MCorp, the principal one of which was that MCorp agree either to downstream all holding company funds into chosen banks and/or merge all of the MBanks.

16. In furtherance of its discussions with the FDIC concerning a recapitalization of the MBanks, on October 7, 1988, MCorp requested open bank assistance by formally submitting the MCorp Assistance Plan.

The Board's Regulatory Actions

17. Despite continuous discussions with the Board, the FDIC and the Comptroller in an effort to develop an overall resolution of MCorp's problems, and without any prior notice to MCorp, on October 19, 1988, the Board issued a notice of charges (the "First Notice of Charges") and two temporary cease and desist orders (the "Initial Temporary Orders") against MCorp. Copies of the First Notice of Charges and the Initial Temporary Orders are

annexed hereto as Exhibits A and B, respectively. The First Notice of Charges alleged:

> MCorp and its management have engaged, are engaging, and unless restrained, will continue to engage in unsafe and unsound practices that have weakened and will continue to weaken seriously the condition of MCorp and the Subsidiary Banks and are *likely to cause substantial dissipation of the assets of MCorp that could be used to allow MCorp to serve as a source of financial strength for the Subsidiary Banks.*

First Notice of Charges at ¶ 6 (emphasis supplied). Pursuant to the First Notice of Charges, the Board set a hearing before an administrative law judge of the Board's choice on such charges and a determination of the appropriate relief.

18. Pending the outcome of the administrative proceedings initiated pursuant to the First Notice of Charges, the Initial Temporary Orders prohibited MCorp, without the consent of the Board, from (a) paying any cash dividends to its stockholders and (b) engaging in any transaction that would have the effect of dissipating MCorp's assets other than (1) interest payments or principal reductions on any outstanding debt that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988, (2) salaries or (3) payments for goods and services that MCorp was obligated to make pursuant to contractual obligations in effect as of October 19, 1988.

19. The allegations set forth in the First Notice of Charges were without any factual basis. MCorp had taken no action which would lead the Board to believe that it intended to dissipate its assets. Indeed, MCorp had made substantial efforts to preserve its assets for infusion into the MBanks in accordance with the MCorp Assistance Plan. For example, on October 24, 1988, MCorp publicly announced a moratorium, effective as of

October 21, 1988, on the payment of all principal of and interest on all of its approximately $470 million of senior and subordinated debt obligations despite the fact that neither the Initial Temporary Orders nor the First Notice of Charges required MCorp to take such actions. By these actions, MCorp sought to preserve its assets for use in connection with a global recapitalization and assistance plan. The Board at all times knew of MCorp's willingness to dedicate its resources to implement a comprehensive recapitalization plan consistent with the interests of its creditors, stockholders and other constituencies.

20. Although MCorp was in full compliance with the Initial Temporary Orders, late in the afternoon of October 26, 1988 (and again without any prior indication to MCorp), the Board issued an "amended" notice of charges (the "Amended Notice of Charges") and a third temporary cease and desist order (the "Third Temporary Order") against MCorp. Copies of the Amended Notice of Charges and the Third Temporary Order are annexed hereto as Exhibits C and D, respectively.[1] The Amended Notice of Charges reiterated the allegations of the First Notice of Charges, but expanded the relief sought. In particular, pursuant to the Amended Notice of Charges, the Board sought a permanent cease and desist order directing MCorp, among other things, to prepare and implement "an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the [MBanks] that are suffering capital deficiencies." Amended Notice of Charges at ¶ 9(d).

21. In the interim, the Third Temporary Order required MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital" and to report to

[1] The First Notice of Charges and the Amended Notice of Charges are sometimes referred to herein collectively as the "October Notices of Charges". The Initial Temporary Orders and the Third Temporary Order are sometimes referred to herein collectively as the "Temporary Orders".

the Board, within 15 days of October 26, 1988, the identity of each MBank into which capital would be infused and the amount of capital to be infused into each such MBank. Third Temporary Order at ¶ 1.

22. The issuance of the Amended Notice of Charges and the Third Temporary Order were coordinated with the issuance on October 27, 1988 by the Comptroller of notices of intent to issue capital directives against eighteen MBanks. Such notices of intent advised the relevant MBanks that the Comptroller intended to issue directives to each such MBank requiring it, among other things, to achieve a minimum level of primary capital.

23. Upon information and belief, the basis for the October Notices of Charges and the Temporary Orders was the Board's self-promulgated and, as yet, untested "source of strength" doctrine. MCorp's attorneys advised me that the "source of strength" doctrine has no basis in law and had no application to the Debtors' then existing circumstances.

24. MCorp's attorneys also advised me that if MCorp complied with the Third Temporary Order and downstreamed its assets to the MBanks without FDIC assistance for such banks, such action would have exposed MCorp and its officers and directors to claims by creditors and stockholders of fraudulent conveyances, corporate waste and mismanagement. At the time that the October Notices of Charges and the Temporary Orders were issued, MCorp had available financial resources of only approximately $250 million to contribute to MBanks that were in need of additional capital and financial assistance in an amount substantially in excess of MCorp's available resources. Obviously, infusion of such limited capital into the MBanks without additional FDIC assistance would have been futile. Indeed, by letter dated October 25, 1988, (the "Shearson Letter"), Shearson Lehman Hutton, one of MCorp's largest creditors and stockholders, expressed to the Board of Directors of MCorp its firm conviction that such a "stopgap" measure would violate

MCorp's fiduciary obligations to its creditors and stockholders. A copy of the Shearson Letter is annexed hereto as Exhibit E. Moreover, on November 9, 1988, Charlifco and Charter National Life Insurance Company filed suit against MCorp in Delaware Chancery Court seeking the issuance of an injunction prohibiting MCorp from taking such actions on the ground that such actions would constitute a fraudulent conveyance under Texas law. A copy of the Charlifco complaint is annexed hereto as Exhibit F. Other creditors and stockholders of MCorp also threatened similar or more drastic actions. Although MCorp advised the federal regulators of such concerns, the FDIC had given MCorp no assurances that if MCorp infused capital into the MBanks before negotiating a recapitalization plan, the FDIC would even consider the interests of MCorp's other constituencies in developing a recapitalization plan.

25. On October 3, 1988, MCorp filed a First Amended Complaint and Application for Injunction (the "Complaint") against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking preliminary and permanent injunctive relief suspending or setting aside the Temporary Orders on the grounds that the Temporary Orders (a) were invalid and without basis in law or fact, (b) damaged the prospects for an FDIC assisted recapitalization plan for the MBanks and undermined public confidence in MCorp and the MBanks, and (c) required MCorp to violate its fiduciary, statutory and contractual duties to its stockholders and creditors. A copy of the Amended Complaint is annexed hereto as Exhibit G.

The Standstill Agreement

26. After extended negotiations, over the weekend of November 5, 1988, MCorp and all of the federal regulators reached a standstill agreement relating to the October Notices of Charges and the Temporary Orders, the

terms of which were embodied in a letter agreement between MCorp and the FDIC dated November 6, 1988 (the "Standstill Agreement"). A copy of the Standstill Agreement is annexed hereto as Exhibit H. In the Standstill Agreement, the FDIC committed to "commence negotiations on [MCorp's] proposal *at once*", while soliciting proposals from third parties. In fact, the Standstill Agreement contemplated a ten-week bidding period and a decision by the FDIC concerning all proposals within two weeks thereafter (*i.e.*, approximately January 31, 1989). For its part, MCorp agreed to use all reasonable efforts to maintain stability in the MBanks, prevent the commencement of a voluntary or involuntary bankruptcy case, and assure the continuation of traditional interbank relationships, in particular interbank funding, among its subsidiary banks, and to cooperate with the FDIC in the bidding process.

27. In conjunction with the Standstill Agreement, by letter dated November 7, 1988 (the "Standstill Letter"), the Board agreed to (a) defer the time for submission of the report of capital injections into the MBanks required by the Third Temporary Order until five days following notice to MCorp from the Board, (b) postpone the administrative and any judicial proceedings relating to the October Notices of Charges and the Third Temporary Order for thirty days from their scheduled dates, and (c) extend the time to file an answer to the October Notices of Charges to November 11, 1988. A copy of the Standstill Letter is annexed hereto as Exhibit I.

The Regulators' "Negotiations" with MCorp

28. Over the course of the next ten weeks and, indeed, at least through the date of the seizure of the MBanks, MCorp cooperated with the federal regulators and fulfilled all of its obligations on a timely basis under the Standstill Agreement. In stark contrast to MCorp's efforts to comply with the Standstill Agreement, and de-

spite the FDIC's written commitment to negotiate with MCorp and Chairman Seidman's assurances to MCorp immediately prior to November 6, 1988, the FDIC never negotiated a recapitalization plan or an assistance program for the MBanks with MCorp.

29. Indeed, in hindsight, it appears to me that the FDIC never really considered an open bank assistance plan for the MBanks, at least after MCorp refused to comply with the regulators' demands that MCorp downstream its assets or otherwise place its assets at risk to subsequent actions by the regulators as a condition to such assistance. Rather, the efforts of the FDIC, acting in concern with the Comptroller and the Board, were singularly directed first toward depriving MCorp of its liquid assets and then delaying any federal assistance while the MBanks lost hundreds of millions of dollars of franchise value to enable the FDIC to implement a "closed bank" scenario. A closed bank scenario would entail the Comptroller declaring the MBanks insolvent, closing them and transferring their assets to a "bridge bank" for liquidation or sale to a third party, all without regard for the legitimate interests in such MBanks of the Debtors' creditors and stockholders.

The Seizure of the MBanks

30. The "hidden agenda" of the federal regulators was implemented after the close of business on March 28, 1989 and before the opening of business on March 29, 1989. In the evening of March 28, without any prior notice, scores of representatives of the Comptroller and the FDIC moved into all twenty-five MBanks. Upon entering the MBanks, the Comptroller immediately closed the seven or eight insolvent MBanks and transferred their assets to the FDIC as receiver. Throughout the night and the next morning, the federal regulators, through a concerted and methodical effort, manufactured the insolvency of at least twelve of the remaining, but previously solvent, MBanks.

31. The Board, at the behest of the FDIC and the Comptroller, demanded without explanation repayment of MBank Dallas' borrowings from the "discount window" at the Federal Reserve Bank of Dallas. This demand was made at a time when MBank Dallas was not in default, had qualifying assets sufficient to collateralize existing borrowings and, in fact, had additional borrowing capacity in excess of $300 million. The Board's act immediately rendered MBank Dallas, which previously had in excess of $50 million of regulatory capital, insolvent.

32. After the Comptroller seized MBank Dallas, all but five of the remaining solvent MBanks were then made to appear insolvent by the wrongful refusal of the FDIC acting as receiver for MBank Dallas to recognize the interbank funding liabilities of MBank Dallas to the solvent MBanks. These were the very same interbank funding obligations that MCorp, at the urging of the FDIC and the Comptroller, was required to use its reasonable efforts to assure were maintained in order to comply with the Standstill Agreement. Yet, by unilaterally determining that such deposits had suffered an impairment of value, the Comptroller, working hand in glove with the FDIC, declared the solvent MBanks insolvent. Indeed, the Comptroller and the FDIC vaguely conceded the means by which they manufactured insolvency in a joint press release dated March 29, 1989, a copy of which is annexed hereto as Exhibit J, in which they admitted that "the bulk of the banks became insolvent due to a combination of loan losses and *Losses from intercompany transactions.*"

33. The treatment by the federal regulators of the interbank funding arrangements between MBank Dallas and the other MBanks contrasts sharply with the treatment of interbank accounts between MBank Dallas and other banks. While the Comptroller and the FDIC forced the MBanks to take significant losses on the interbank accounts, the claims of other banks and depositors were

paid in full. If, however, the interbank accounts of the MBanks were, as the treatment by the Comptroller and the FDIC suggests, unsafe or unsound, the Comptroller should have forced the MBanks to clarify or write down such amounts in conjunction with its previously completed examinations of the MBanks. In such examinations, although the Comptroller forced the MBanks to write off hundreds of millions of dollars of loans, none of such writeoffs involved the MBanks' funding arrangements with MBank Dallas and MBank Houston, N.A. ("MBank Houston").

34. Thereafter, the FDIC obtained *ex parte* orders from the United States District Courts in all four Texas districts approving the transfer of certain deposits and other liabilities, and certain assets of the receivership estates of the twenty MBanks to The Deposit Insurance Bridge Bank, National Association (the "DIBB"), a newly created entity wholly owned by the FDIC.

35. The actions by the federal regulators on March 28 and 29 left MCorp with only five MBanks (the "Remaining MBanks"), with a net book value as of December 31, 1988 of approximately $125 million.

36. MCorp's attorneys have advised me that the actions of the federal regulators on March 28 and 29 not only violate every fundamental precept of good faith and fair dealing, but that such actions were beyond the statutory authority of the Comptroller and the FDIC. Accordingly, MCorp has filed an action against the Comptroller and the FDIC in the United States District Court for the Northern District of Texas, Dallas Division, asserting that the FDIC and the Comptroller, in seizing twelve or more solvent MBanks, exceed their statutory authority and wrongfully deprived MCorp of its property without just compensation. A copy of the Amended Complaint is annexed hereto as Exhibit K. Pursuant to the Amended Complaint, MCorp seeks injunctive relief and damages in excess of $70 million.

The March Notice of Charges and the MNet Transaction

37. Within one day after the Comptroller seized the twenty MBanks, the Board commenced a new round of administrative proceedings against MCorp and MCorp Management by issuing a notice of charges dated March 30, 1989 (the "March Notice of Charges"). A copy of the March Notice of Charges is annexed hereto as Exhibit L. The March Notice of Charges alleges that MCorp and MCorp Management have engaged, are engaging and, unless restrained, *will continue* to engage in violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, in that MCorp and MCorp Management allegedly caused MBank Houston and MBank Dallas, two of the MBanks seized by the Comptroller and transferred to the DIBB, to extend to MCorp Management "unsecured extensions of credit." March Notice of Charges at ¶ 5. The March Notice of Charges further alleges that MCorp and MCorp Management

> have engaged, are engaging and, unless restrained, *will continue* to engage in unsafe and unsound practices in that (a) MCorp and MCorp Management have failed to cause MBank Dallas and MBank Houston to record or report properly on their books and financial statements the amounts due from MCorp Management on the unsecured extensions of credit . . ., (b) MCorp Management has not properly recorded or reported on its books and financial statements the unsecured extensions of credit from these two Subsidiary Banks, and (c) MCorp Management had failed to account properly for the arrearages totalling over $14 million that are due to MBank Dallas and MBank Houston and has failed to record or report such arrearages on its books and financial statements.

March Notice of Charges at ¶ 6. The March Notice of Charges sets May 29, 1989 as the date on which an ad-

ministrative law judge designated by the Board will conduct a hearing to take evidence and determine whether an appropriate order should be issued. March Notice of Charges at ¶ 9.

38. Like the October Notices of Charges, the March Notice of Charges simply has no factual basis. The alleged "unsecured extensions of credit" and "unsafe and unsound practices" in the March Notice of Charges relate to a transaction—the "MNet Transaction"—which occurred more than two years ago. The MNet Transaction has its origins in transactions which formed part of the reorganization of MCorp's credit card operations.

39. Specifically, on August 1, 1985, MBank Houston and MBank Preston, N.A. ("MBank Preston"), which subsequently was merged into MBank Dallas, sold certain assets of their credit card operations to MBank USA, a wholly owned subsidiary of MNet Corp ("MNet"), itself a wholly owned subsidiary of MCorp Financial. In connection with such sale, and to fund the ongoing operations of MBank USA, MBank Houston and MBank Preston sold federal funds on August 1, 1985 in the approximate aggregate amount of $364 million to MBank USA "until further notice", pursuant to letter agreements dated August 1, 1985 and October 9, 1985 (collectively, the "Letter Agreements"). Banks routinely buy and sell federal funds. In an "until further notice" federal funds transaction, the selling bank typically agrees to transfer to the buying bank a specified amount of federal funds and, in exchange, the buying bank agrees to pay the selling bank interest at a Federal Funds rate and to retransfer the federal funds upon demand.

40. In exchange for the use of MBank Houston's and MBank Preston's federal funds, MBank USA agreed to (a) repay the principal amount of and interest due on such federal funds upon receipt of demand and (b) pay as "Additional Contingent Fees" the lesser of a fixed sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of (i) payment of a specified

amount to each particular bank or (ii) December 31, 1993. Copies of the Letter Agreements are annexed hereto as Exhibits M and N. According to the terms of the Letter Agreements, MBank USA's obligation to pay Additional Contingent Fees survived the termination of the sale of federal funds and the repayment of principal and interest relating thereto.

41. In the MNet Transaction, MCorp Financial sold the capital stock of MNet to Lomas & Nettleton Financial Corporation ("L&N") in exchange for cash, promissory notes issued by L&N (the "L&N Notes"), Series B Preferred Stock of L&N (the "L&N Preferred Stock") and common stock of L&N, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. In connection with such sale, MBank Houston and MBank Preston agreed to (a) terminate their respective federal funds transactions with MBank USA and (b) release MBank USA from its obligations to pay the Additional Contingent Fees. In consideration therefor, MBank Houston and MBank Preston requested a substitute arrangement to compensate them for the Additional Contingent Fees from MBank USA to which they originally were entitled.

42. To facilitate the sale of MNet to L&N, MCorp Management agreed to provide such substitute contingent payment arrangement by paying MBank Houston and MBank Preston an aggregate amount equal to the lesser of (a) the sum of the interest actually received by MCorp Management on the L&N Notes and the dividends actually received by MCorp Management on the L&N Preferred Stock or (b) quarterly cash payments aggregating $2,853,000 (the "Contingent Payments"). Copies of the Agreements embodying such arrangements are annexed hereto as Exhibits O and P. Like MBank USA's obligation to pay the Additional Contingent Fees for which the Contingent Payments were intended as a substitute, MCorp Management's obligation to make the Contingent Payments terminated on the earlier of payment in full of

the amount of Additional Contingent Fees then due or December 31, 1993.

43. The March Notice of Charges characterizes MCorp Management's obligation to make the Contingent Payments either as "unsecured extensions of credit" (March Notice of Charges at ¶ 5(b)(1)) by MBank Dallas and MBank Houston to MCorp Management or as repayment of "unsecured extensions of credit" (March Notice of Charges at ¶ 5(a)(1)). I have been advised by MCorp's attorneys that there is no basis in law or fact to characterize the Contingent Payments as "extensions of credit". The Contingent Payments cannot be considered an "extension of credit" because no funds or other properties of MBank Houston and MBank Preston were ever received by MCorp Management in exchange or consideration for the Contingent Payments. The Contingent Payments merely represent an override on revenues that MCorp Management may or may not receive as interest and dividends on the L&N Notes and L&N Preferred Stock, with a defined maximum amount of $2,583,000 quarterly.

44. Moreover, MCorp Management is not in arrears on any obligation it may have to the FDIC, in its capacity as receiver of MBank Dallas and MBank Preston, or to the DIBB, as transferee from the receivership estates of MBank Dallas and MBank Houston of any such alleged claims against MCorp Management because MCorp Management has made substantial payments for and on behalf of MBank Dallas and MBank Houston which as of March 31, 1989 more than offset the amounts allegedly owing to such banks at that time.

45. Accordingly, on April 19, 1989, MCorp and MCorp Management filed an Answer to the March Notice of Charges challenging the authority of the Board to bring such action and denying the legal and factual bases of the March Notice of Charges. A copy of the Answer is annexed hereto as Exhibit Q. In such Answer, MCorp and MCorp Management expressly reserved the right to bring this action.

Reasons for Relief

46. I believe that compliance with the Board's directives and continued prosecution of the administrative proceedings would seriously prejudice the Debtors and the rights and interests of their creditors and stockholders. The October Notices of Charges and the Temporary Orders seek to force MCorp to downstream substantially all of its liquid assets into the MBanks. In view of the pendency of the chapter 11 cases and the seizure of the MBanks, the October administrative proceedings are patently moot. Such proceedings, on their face, apply to all twenty-five MBanks, twenty of which are no longer under the direct or indirect control of MCorp. Moreover, the remaining five MBanks are solvent. Despite their efforts on March 28 and 29, the federal regulators were unable to manufacture their insolvency.

47. To the extent that the October Notices of Charges and Temporary Orders attempt to prohibit MCorp from dissipating its assets, such proceedings are completely unnecessary and MCorp's attorneys advise me that continued prosecution of such proceedings would constitute an affront to this Court's exclusive jurisdiction over the Debtors' property. Not only does MCorp have no intention of dissipating its assets, but, as MCorp's attorneys advise me, the Bankruptcy Code prohibits the use, sale or lease outside of the ordinary course of business of *any* of the Debtors' property without this Court's prior approval. Such control over the Debtors' assets serves to insure an appropriate balance of the respective rights and interests of all of the Debtors' creditors, stockholders and other parties in interest, including the federal regulators. If, however, the Board is permitted to proceed on the October Notices of Charges or institute other administrative proceedings based on the "source of strength" doctrine, there exists a substantial risk that the assets of the Debtors' estates will be depleted without affording the Debtors' creditors and stockholders an opportunity to be heard or the Debtors an opportunity to reorganize. On

the other hand, there will be little or no prejudice to the legitimate interests of the Board if the relief requested is granted. Just like other parties in interest in the Debtors' chapter 11 cases, the Board may appear and be heard in any matter in which it has an interest.

48. Similarly, continued prosecution of the March Notice of Charges is pointless in view of the pendency of the Debtors' chapter 11 cases. As noted above, the Board's administrative proceedings commenced in March seek a determination that the Contingent Payments are "extensions of credit" and that MCorp Management owes money to the FDIC, as receiver for MBank Houston and MBank Dallas, or to the DIBB, as transferee of the assets of the receivership estates of MBank Houston and MBank Dallas. The Board's March Notice of Charges issued under the guise of enforcement and regulatory action is without legal or factual merit and I believe is intended to harass the Debtors and to improve the position of the FDIC.

49. The Debtors vigorously dispute the Board's characterization of the transactions as "extensions of credit" and deny that any payments were due to MBank Houston and MBank Dallas arising out of MCorp Management's Contingent Payment obligations. In fact, MCorp Management has made a number of cash payments on behalf of or otherwise provided direct financial support to such MBanks which exceed the maximum amount of the outstanding Contingent Payments allegedly owing. Moreover, regardless of the merits of these assertions, the March administrative proceeding mirrors a typical commercial dispute. If the Board is permitted to proceed on the March Notice of Charges, MCorp's attorneys advise me that one effect of its actions would be an adjudication of the validity of a prepetition claim of the FDIC and a prepetition setoff against those claims. I believe that this dispute should, like any other dispute with a chapter 11 debtor, be heard in this Court in accordance with the procedures and protections contemplated by section 502

of the Bankruptcy Code and the pertinent Bankruptcy Rules.

50. Unless the Board is enjoined from exercising its purported enforcement powers against the Debtors and their assets, I believe their actions will substantially and irreparably harm the Debtors' estates, their creditors and stockholders. If the Board is permitted to continue to prosecute its administrative proceedings, the Debtors will be forced to commit substantial resources to preparing for and defending the charges relating to a prepetition claim at a time when the Debtors' limited economic and personnel resources can be put to more effective uses. Dedicating personnel and economic resources would have a devastating effect on the administration of the Debtors' estates and could cripple the Debtors' efforts to successfully reorganize.

51. Simply put, at this critical time, the Debtors need to direct all of their limited resources to the stabilization of their businesses and the implementation of the chapter 11 process. The Debtors do not have sufficient personnel and economic resources to commit to prepare for and defend a typical commercial dispute for which the proper course of action is to file a proof of claim.

52. The Debtors have only approximately twenty-seven employees. In addition to myself, such employees include the President and Chief Operating Officer and the Group Chairman—Chief Financial Officer. Of the remaining employees, approximately five have general responsibility for the financial and business affairs of the Debtors and their non-debtor subsidiaries. Prior to the seizure of the MBanks, MBank employees provided the bulk of the technical services to the MCorp enterprise, including other MBanks.

53. Since the receivership of the twenty MBanks, the few remaining MCorp employees have had to assume considerably more responsibility for the supervision of the five Remaining MBanks and the Debtors' other banking and non-banking subsidiaries. Specifically, the Debtors'

employees have had to assume responsibility for accounting, financial reporting and compliance with banking regulations previously delegated to the former MBank employees.

54. In addition ot the responsibilities relating to the MBanks, the pendency of the Debtors' chapter 11 cases has also imposed substantial new obligations on the Debtors' employees. Since the filing of the chapter 11 cases, the Debtors' employees have had to devote substantial time and effort in compiling and assembling the various information required to complete the required reports, statements and schedules relating to the commencement of a bankruptcy case. The Debtors' personnel have also been involved in various meetings with the United States Trustee and constant communication with the Debtors' attorneys.

55. Moreover, the Debtors' chapter 11 cases will necessitate an even greater commitment of time and attention of the Debtors' employees. The Debtors' attorneys have advised me that most likely there will be numerous hearings and matters relating to the overall administration of a chapter 11 case in addition to a substantial amount of litigation. Preparing for and prosecuting or defending such litigation will impose a substantial, additional drain on the limited management time and attention. Following the initial stabilization, the Debtors' attention will necessarily turn to the development of a business plan for the Debtors. The creation of a business plan obviously will require the attention of MCorp management at all levels, along with coordination with the Debtors' attorneys, accountants, investment bankers and others. Once that plan is in place, the efforts of all parties in interest in the Debtors' chapter 11 cases will turn to the development of a plan or plans of reorganization. Of necessity, the development and negotiation of a plan will require an enormous commitment of time of the Debtors' employees communicating with the Debtors' creditors, stockholders and other constituents, particularly in view of the unusual nature of these chapter 11 cases and the number

of parties in interest who undoubtedly will have counsel and maybe even investment bankers.

56. In view of the Debtors' limited resources, continued prosecution of the Board's administrative proceedings would divert critical management time and attention from the larger issues facing the Debtors. Such actions could frustrate the Debtors' chances for a successful reorganization at this early stage of their chapter 11 cases and maybe even destroy any hope for a successful reorganization. The Debtors' valuable attention and limited professional resources should be employed for the more important goals of rehabilitating the Debtors and preserving the Debtors' assets for the benefit of all creditors and stockholders.

57. Accordingly, I believe that it is imperative that the Court enter a temporary restraining order and a preliminary injunction (1) restraining and enjoining the Board from prosecuting its administrative proceedings and enforcing the Temporary Orders and (2) restraining and enjoining the Board from commencing any further administrative proceedings or actions to obtain or enforce a cease and desist order or other relief against any of the Debtors or any property of the Debtors' estates without the prior approval of this Court after notice and a hearing.

58. No previous application for the relief requested herein has been made to this or any other Court.

/s/ Gene H. Bishop
GENE H. BISHOP

Subscribed and sworn to this
1st day of May 1989 —

/s/ Ann E. Meek
ANN E. MEEK
Notary Public State of Texas
My Commission expires 2/25/92

[Certificate of Service Omitted in Printing]

Jeffrey B. Lane
President and
Chief Operating Officer

SHEARSON
LEHMAN
HUTTON
An American Express Company

October 25, 1988

The Board of Directors
MCorp
P.O. Box 655415
Dallas, Texas 75265-5415

Gentlemen:

We are the holder of $29,000,000 of MCorp's Floating Rate Subordinated Capital Notes Due 1997, and 235 shares of MCorp's Money Market Cumulative Preferred Stock (with an aggregate liquidation preference of $117.5 million). We are writing as a result of recent developments affecting MCorp and MCorp's announcement yesterday that its Board of Directors has determined that MCorp is not at present in a position to make payments of interest or principal when due on MCorp's long-term debt, or to pay dividends on any class of MCorp stock.

We wrote to you on August 24, 1988 to express our concern that the financial condition of MCorp's major bank subsidiaries is precarious and deteriorating, that even with an infusion of all of MCorp's available funds there would be no reasonable prospect of returning these bank subsidiaries to profitability, and that it would therefore be wholly inconsistent with the Board's duty to MCorp's creditors and stockholders to make any further investment in or extension of credit to these subsidiaries. Events since August 24, including MCorp's October 7 request for FDIC assistance, its October 7 announcement of an estimated consolidated third quarter loss of $525 million, and yesterday's announcement of a payment moratorium, have confirmed that any further MCorp in-

vestment in or credit extension to these bank subsidiaries would be wasteful and wrong. The Board's duty now is to preserve MCorp's value by all means necessary, and we believe the means considered should include the immediate filing of a voluntary petition under Chapter 11 of the Bankruptcy Code.

On October 7, MCorp announced that it is seeking substantial "open bank" assistance from the FDIC in connection with a proposed recapitalization of the holding company and its subsidiary banks. We publicly stated our support for that effort. We continue to support, strongly, the Board's determination that MCorp's lead banks can be saved only by a recapitalization, involving the FDIC and all other parties now at risk, at a level adequate to place them in a sound financial condition and return them to profitability.

Yesterday's announcement acknowledges that, although the parent company has significant nonbank assets, and although several of its bank subsidiaries have positive values, MCorp is unable under all the circumstances to continue making payments on its long-term debt. It also reflects MCorp's determination to stop the flow of assets out of the parent company and its healthy subsidiaries until there can be either an adequate recapitalization, in which all interests are fairly treated and appropriately protected, or a decision that the deteriorating banks will be disposed of.

The decision to stop the payment of cash to creditors and stockholders heightens the Board's obligation to take whatever other measures are necessary to avoid wasting the significant assets that now stand behind MCorp's obligations to its security holders. In particular, it now would be even more obviously improper for the Board to allow MCorp to risk its own assets, or those of its nonbank or healthy bank subsidiaries, on stopgap measures that will only prolong the deterioration of the troubled bank subsidiaries. MCorp has acknowledged that an FDIC-assisted recapitalization is necessary to return the

troubled banks to profitability. No further investment in, extension of credit to, or guarantee of the obligations of, any of the troubled banks would be justified except simultaneously with (not prior to) and as an integral part of such recapitalization on terms that are fair to creditors and stockholders.

The Board should use all means necessary to resist wastefully depleting MCorp's assets and bargaining power before the needed recapitalization has been negotiated. Specifically, we understand that the Board has considered the advisability and consequences of voluntarily placing MCorp into proceedings under Chapter 11 and has referred to this option as a part of its assistance proposal to the FDIC. We believe that the Board's acknowledgment of MCorp's present inability to pay its long-term debt and its need for an overall recapitalization make such an action appropriate, and we would support such an action at this time as a means of protecting MCorp's present value.

For our part, we are prepared to work with you, other creditors and stockholders, new investors, and the FDIC toward recapitalization that fairly and adequately resolves MCorp's problems. We are not prepared, however, to see our substantial investment in MCorp lose its value because of imprudent stopgap support (in any form) that will not restore the troubled banks to profitability but will only deplete MCorp's assets and imperil its now healthy bank and nonbank subsidiaries. We would resist any such course by all necessary steps, including steps to place MCorp in Chapter 11 should that become necessary and should the Board be unwilling to do so.

We would of course be pleased to discuss this matter with the appropriate representatives of MCorp at any time.

Sincerely,

/s/ Jeffrey B. Lane
JEFFREY B. LANE
President

IN THE COURT OF CHANCERY
OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

C.A. No. 10426

CHARLIFCO, a Missouri general partnership, and CHARTER NATIONAL LIFE INSURANCE COMPANY, a Missouri corporation, PLAINTIFFS

v.

MCORP, a Delaware Corporation, DEFENDANT

[Filed: Nov. 9, 1988]

COMPLAINT

For this complaint, plaintiffs Charlifco and Charter National Life Insurance Company ("Charter") allege as follows:

1. Charlifco is a Missouri general partnership and is a nominee partnership used to effect investments solely for Charter. Charter is a corporation organized and existing under the laws of the State of Missouri.

2. Defendant MCorp is a corporation organized and existing under the laws of Delaware, with its principal place of business in Dallas, Texas.

3. Charter is a life insurance company and receives insurance premiums from its policyholders. The proceeds of these premiums are invested in long-term investments

in accordance with Missouri law and regulations established by the Commissioner of Insurance for Missouri. Charter makes such investments primarily through Charlifco.

4. Like other insurance organizations, Charter provides substantial amounts of long-term capital to the banking industry, primarily through the purchase of debt securities issued by bank holding companies. These securities are generally purchased for the purpose of long-term investment and not for short-term speculation.

5. Charter, through Charlifco, purchased $6,725,000 principal amount of certain 11.504 Debenture Notes issued by Mercantile Texas Corporation, which subsequently changed its name to MCorp (the "Debenture Notes"), which Debenture Notes mature on December 15, 1989. Charlifco is and was at all relevant times the holder of record of the Debenture Notes.

6. MCorp is a bank holding company which owns the capital stock of 26 banks (the "MCorp Banks").

7. The MCorp Banks, on a consolidated basis, are insolvent as defined in the fraudulent conveyance statutes of both the State of Texas and the State of Delaware ("insolvent"). 4 *Tex. Bus. & Com.* Code Ann. Chapt. 24 *and* 6 *Del. C.* Chapt 13 (the "Fraudulent Conveyance Statutes").

8. For the year ended December 31, 1986, MCorp lost $301,000,000 (after excluding two one-time extraordinary non-recurring gains).

9. For the year ended December 31, 1987, MCorp lost $258,300,000.

10. During the past ten months, the financial condition of MCorp has deteriorated even more dramatically, having lost $62,400,000 for the quarter ending March 31, 1988, $169,300,000 (after excluding a one-time extraordinary non-recurring gain) for the quarter ending June 30, 1988, and $517,000,000 for the quarter ending September 30, 1988. Thus, through September 30, 1988,

MCorp has lost $748,700,000, and since 1986, more than $1,300,000,000.

11. Between year end 1986 and 1987, MCorp's assets declined by $1,700,000.00.

12. Between June 30, 1987 and June 30, 1988 (the last period for which financials are publicly available), MCorp's assets declined in excess of $2,000,000,000.

13. All of the losses which MCorp has suffered over the past three years are directly attributable to the MCorp Banks.

14. During the past three years, MCorp has been liquidating all of the substantial assets owned directly by it.

15. On December 30, 1986, MCorp sold its subsidiary MNet Corp. for $300,000,000.

16. On April 19, 1988, MCorp said its 804 interest in MTech Corp., the leading financial data processing company in the United States, for $292,000,000.

17. On information and belief, MCorp has retained at the parent level more than $400,000,000 of the cash and marketable securities which it received from the sale of its assets.

18. On information and belief, the MCorp Banks require an investment in excess of $1,000,000,000 in order not to be insolvent on a consolidated basis.

19. On October 7, 1988, MCorp filed with the Federal Deposit Insurance Corporation (the "FDIC") a request for assistance. On information and belief, MCorp proposed to the FDIC a recapitalization plan for the MCorp Banks requiring FDIC assistance in an amount in excess of $1,000,000,000, new equity investments in the amount of $400,000,000 in cash and marketable securities raised from the sale of the parent company's assets, without any consideration being received by MCorp therefor.

20. On information and belief, the FDIC refused to consider MCorp's proposal unless MCorp contribute to the MCorp Banks $400,000,000 in cash and marketable securities prior to the FDIC committing to any recapitalization plan for the MCorp Banks.

21. On or about October 20, 1988, the FDIC began pressuring MCorp to immediately contribute to the MCorp Banks $400,000,000 in cash and marketable securities by having the Federal Reserve Board issue a temporary order preventing MCorp from declaring dividends on its common and preferred stock and from engaging in the dissipation of assets of MCorp without the prior apppoval of the Federal Reserve Board. If the preferred shareholders' dividends are not paid by November 21, 1988, MCorp will be in default and could be forced into bankruptcy.

22. On October 21, 1988, MCorp failed to make a payment of interest due on certain notes which it had issued. If the payment of interest is not made by November 21, 1990, MCorp will be in default and could be forced into bankruptcy.

22. On October 24, 1988, MCorp announced that it had lost $127,000,000 during the third quarter of 1988 and that it was suspending payment of all preferred stock dividends and all principal and interest on all of its public and privately placed indebtedness, including the Debenture Notes.

24. Also, on October 24, 1988, MCorp announced that it intended to use the monies due its creditors, together with all of its other assets, to recapitalize the MCorp Banks.

25. On or about October 28, 1988, MCorp announced that it expected to be in bankruptcy by November 20, 1988. If MCorp does not meet its dividend payment deadline of November 20, 1988, it will be in default and could be forced into bankruptcy.

26. During the last few days of October, the FDIC continued to pressure MCorp by having the Comptroller of the Currency notify eighteen of the MCorp Banks that it intends to demand that they raise more capital and by having the Federal Reserve Board order MCorp to draft a plan to boost the MCorp Banks' capital. All of this is designed to force MCorp to contribute $400,-

000,000 in cash and marketable securities to the MCorp Banks.

27. On information and belief, MCorp intends to transfer in cash and marketable securities to the MCorp Banks without receiving reasonable equivalent value and fair consideration as respectively defined in the Texas and Delaware Fraudulent Conveyance Statutes ("reasonable equivalent value" and "fair consideration"). On information and belief, MCorp intends to make one such transfer prior to November 20, 1988 in the amount of approximately $400,000,000.

COUNT I
(Fraudulent Transfer)

28. Plaintiffs repeat and reallege each of the allegations contained in paragraphs 1 through 28 of this complaint.

29. MCorp either is insolvent or will become insolvent as a result of the transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000.

30. The transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000 in cash and marketable securities, without reasonable equivalent value and fair consideration, will constitute a fraudulent transfer in violation of the Fraudulent Conveyance Statutes.

31. Plaintiffs will be irreparably harmed by such fraudulent conveyance.

32. Plaintiffs have no adequate remedy at law.

33. Plaintiffs are entitled to relief pursuant to the Fraudulent Conveyance Statutes.

COUNT II
(Fraudulent Transfer)

34. Plaintiffs repeat and reallege paragraphs 1 through 28 and paragraphs 29 through 34 of this Complaint.

35. Any transfer to the MCorp Banks by MCorp of all, or any part, of the $400,000,000 in cash and marketable securities will be with actual intent to hinder, delay or defraud plaintiffs in violation of 6 *Del. C.* § 1307 and 4 *Tex. Bus & Com.* Code Ann. § 24.008(a)(1).

36. Plaintiffs will be irreparably harmed by such fraudulent conveyance.

37. Plaintiffs have no adequate remedy at law.

38. Plaintiffs are entitled to relief pursuant to the Fraudulent Conveyance Statutes.

WREREFORE, plaintiffs respectfully request that this Court grant judgment as follows:

A. Pursuant to Count I, temporarily restraining and preliminarily and permanently enjoining MCorp from transferring to the MCorp Banks cash and marketable securities without receiving reasonable equivalent value and fair consideration;

B. Pursuant to Count II, temporarily restraining and preliminarily and permanently enjoining MCorp from transferring to the MCorp Banks cash or marketable securities; and

C. For such other and further relief as this Court deems just and proper.

/s/ Stephen R. Herrmann
R. FRANKLIN BELOTTI
STEPHEN R. HERRMANN
RICHARDS, LAYTON & FINZER
One Rodney Square
P.O. Box 351
Wilmington, Delaware 13899
(302) 658-6541
Attorneys for Plaintiffs

Of Counsel:

BUTLER, FITZGERALD & POTTER
A Professional Corporation
315 Park Avenue South
New York, New York 10010
(212) 473-1200

Date: November 9, 1988

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

No. CA3-88-2693-F

MCORP, PLAINTIFF

v.

BOARD OF GOVERNORS OF THE FEDERAL
RESERVE SYSTEM, DEFENDANT

[Filed: Nov. 3, 1988]

FIRST AMENDED COMPLAINT AND APPLICATION FOR INJUNCTION

MCorp files its First Amended Complaint and Application for Injunction against Defendant Board of Governors of The Federal Reserve System as follows:

PARTIES

1. MCorp is a Delaware corporation which maintains principal places of business in Dallas and Houston, Texas.

2. The Board of Governors of the Federal Reserve System (the "Board") is an agency or instrumentality of the United States of America, which may be served with process herein by service of the Summons and Complaint on Marvin Collins, United States Attorney for the Northern District of Texas, 1100 Commerce Street, Dallas, Texas, by sending a copy thereof by registered mail to Richard Thornburgh, Attorney General of the United States, Washington, D.C., and by sending a copy thereof by certified mail to the Board in Washington, D.C.

JURISDICTION AND VENUE

3. This Court has jurisdiction of this action pursuant to 28 U.S.C. §§ 1331, 1337 and 2201 *et seq.*, and pursuant to the Federal Deposit Insurance Act, 12 U.S.C. § 1818.

4. Venue of this action in this District and Division is proper pursuant to 28 U.S.C. § 1391(b) and (d), and pursuant to 12 U.S.C. § 1818.

SUMMARY OF CLAIMS

5. MCorp is the second largest bank holding company in the State of Texas, with twenty-six bank subsidiaries throughout the state and almost twenty billion dollars in book value of consolidated assets. Throughout the unprecedented upheaval in the banking industry of Texas in recent years, MCorp has distinguished itself as a hardy survivor. As of October 1, 1988, MCorp was the only one of the eight largest Texas bank holding companies which had not been acquired by out-of-state interests, or made application for federal assistance.

6. Through a series of strategic management actions over the last decade, MCorp developed substantial value in a number of nonbank subsidiaries. In recent years, MCorp sold many of these subsidiaries at a significant profit. No other bank holding company in the region met with success in such efforts comparable to the success of MCorp. As a result, MCorp retains approximately $250 million in cash and other liquid assets today.

7. MCorp has not, of course, been unaffected by the severely depressed economic conditions that have afflicted virtually all major financial institutions in Texas. Its nonperforming assets have substantially grown since 1985, now exceed 1.5 billion dollars. It has sustained major losses in its banking subsidiaries. Accordingly, it made an early and voluntary decision in late 1986 to suspend dividends on its common stock. Finally, however, the collapse of the regional economy took its toll. As a result, MCorp on October 7, 1988, made a request that the Federal Deposit Insurance Corporation ("FDIC") provide MCorp's bank subsidiaries with federal assistance pursuant to 12 U.S.C. § 1823(c).

8. After October 7, 1988, MCorp remained in frequent contact with the Board. During such contacts, MCorp advised the Board that MCorp had scheduled a meeting of MCorp's Board of Directors for October 21, 1988, and that consideration would be given at such meeting to suspending dividends on MCorp's preferred stock, and to other steps to conserve MCorp's resources.

9. Despite this information, on an *ex parte* basis, and without notice of any kind to MCorp, the Board on October 19, 1988, issued Temporary Orders to Cease and Desist to MCorp in Docket No. 88-062-C-HL. The Temporary Orders to Cease and Desist prohibited certain actions by MCorp relating to the alleged potential dissipation of MCorp assets. This action was wholly without any factual or legal basis, in that MCorp had not taken any action which would justify a conclusion that it was about to dissipate its assets.

10. In fact, MCorp's Board of Directors at its October 21, 1988, meeting decided to suspend all dividends on its preferred stock and to impose a moratorium on payments of principal and interest on approximately $470 million in debt. This moratorium was not required by the Temporary Cease and Desist Orders, and will result in the conservation of tens of millions of dollars

of MCorp assets in excess of that required by the Board's precipitous and premature Orders.

11. Thus, it is indisputably clear that the *ex parte* Orders of the Board issued on October 19 were unfounded. MCorp never had and does not have any intention to dissipate its assets. Moreover, the Orders are unreasonable, oppressive, and render impractical the conduct of the normal business operations of MCorp. The October 19 Cease and Desist Orders therefore should be suspended, set aside and/or modified by this Court as expressly authorized in 12 U.S.C. § 1818(c)(2).

12. On October 26, 1988, the Board issued another Temporary Cease and Desist Order to MCorp, again on an *ex parte* basis and without notice to MCorp of any kind. This Order purports to require MCorp to "take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks in need of additional capital." The Order does not direct MCorp to actually provide such capital to Subsidiary Banks, but directs MCorp to report to the Board by November 10, 1988 "on the identity of those Subsidiary Banks into which capital injections will be made by MCorp and the amount of capital to be injected into each such Bank."

13. The October 26, 1988 Temporary Cease and Desist Order is based upon the "source of strength" theory outlined in policy statements and regulations of the Board, but not in any statute. According to the Board's theory, a bank holding company has an absolute duty to use all of its assets to provide capital to its subsidiary banks, and to disregard the rights of its shareholders and creditors with respect to such assets. The policy statements and regulations of the Board to this extent have no basis in the statutes which govern the Board, and exceed its legal authority. Accordingly, the October 26, 1988, Temporary Cease and Desist Order is without legal basis, and should be suspended, set aside, and/or modified by this Court as expressly authorized in 12 U.S.C. § 1818(c)(2).

FIRST CAUSE OF ACTION

(Preliminary and Permanent Injunction as to October 19 Temporary Cease and Desist Orders)

14. MCorp realleges Paragraphs 1 through 13 hereof.

15. The Temporary Cease and Desist Orders entered against MCorp by the Board without notice or hearing on October 19, 1988, are invalid and without basis in law or fact. The pendency of these Orders threatens MCorp with immediate and irreparable harm and injury for which there is no adequate remedy at law and which is likely to occur prior to a final hearing in this matter. In particular, MCorp is threatened with damage both to the prospects for a federally assisted recapitalization plan for MCorp's bank subsidiaries and to public confidence in MCorp and its bank subsidiaries. Accordingly, MCorp is entitled to preliminary and permanent injunctions suspending, setting aside, and/or modifying the Temporary Cease and Desist Orders entered against MCorp on October 19, 1988.

SECOND CAUSE OF ACTION

(Preliminary and Permanent Injunction as to October 26 Temporary Cease and Desist Order)

16. MCorp realleges Paragraphs 1 through 15 hereof.

17. The Temporary Cease and Desist Order entered against MCorp by the Board without notice or hearing on October 26, 1988, is invalid and without legal basis. The pendency of this Order threatens MCorp with immediate and irreparable injury for which there is no adequate remedy at law and which is likely to occur prior to a final hearing in this matter. In particular, MCorp is threatened with damage to the prospects for a federally assisted recapitalization plan for MCorp's bank subsidiaries, with damage to public confidence in MCorp and its bank subsidiaries, and with damage to the financial viability of MCorp and the legitimate interests of its shareholders and creditors. Moreover, if the asset

transfers contemplated by the Order were made, the result would be an irreparable violation of the fiduciary, statutory, and contractual obligation of MCorp to its shareholders and creditors. Accordingly, MCorp is entitled to preliminary and permanent injunctions suspending, setting aside, and/or modifying the Temporary Cease and Desist Order entered against MCorp on October 26, 1988.

WHEREFORE, PREMISES CONSIDERED, MCorp prays that the Board be required to appear and answer herein; that the Court enter a preliminary injunction on due notice and hearing, suspending, setting aside, and/or modifying the Temporary Cease and Desist Orders entered by the Board on October 19, 1988, and on October 26, 1988; that the Court on final hearing enter a permanent injunction suspending, setting aside, and/or modifying such Temporary Cease and Desist Orders; and that the Court grant such other and further relief to MCorp to which it may be entitled.

Respectfully submitted,

HUGHES & LUCE
2800 Momentum Place
1717 Main Street
Dallas, Texas 75201
(214) 939-5500
Thomas W. Luce, III
State Bar No. 12666000
David Bryant
State Bar No. 03281500

By: /s/ Thomas W. Luce III
ATTORNEYS FOR MCORP

VERIFICATION

I, Gene H. Bishop, Chairman of the Board of Directors and Chief Executive Officer of MCorp, state on my oath that I have read the foregoing pleading, and that the factual statements set forth therein are true and correct to the best of my knowledge and belief.

/s/ Gene H. Bishop
GENE H. BISHOP

THE STATE OF TEXAS)
)
COUNTY OF DALLAS)

The foregoing verification was sworn to before me on November 3rd, 1988 by Gene H. Bishop, Chairman of the Board of Directors and Chief Executive Officer of MCorp, a Delaware corporation, on behalf of said corporation.

/s/ [Illegible]
Notary Public in and for
the State of Texas

November 6, 1988

Gene M. Bishop
Chairman of the Board and
Chief Executive Officer
MCorp
Dallas, Texas 78265

Dear Mr. Bishop:

The Board of Directors of the Federal Deposit Insurance Corporation has met to consider your proposal to recapitalize the subsidiary banks of MCorp under Section 13(c) of the Federal Deposit Insurance Act. Our initial analysis indicates that your proposal is one that merits consideration by our Board. While there are problems with the proposal that we would like to discuss with you, we are prepared to commence negotiations on your proposal at once.

At the same time, as provided by FDIC policy, we will solicit proposals from third parties to determine the most effective and least cost resolution of this matter. We anticipate approximately a ten week period during which we would contact, screen and qualify investors, allow them to examine information on MCorp and its subsidaries, and do a limited amount of due diligence prior to formulating a proposal. It is expected that upon completion of the solicitation of proposals, as outlined herein, the FDIC Board of Directors would consider all proposals and would expect to reach a decision within two weeks.

While you and we are proceeding as outlined above, you agree to the following:

First, that MCorp use all reasonable efforts to maintain stability in all subsidiary banks. That is, MCorp will not initiate a voluntary liquidation of any subsidiary bank and it will seek to retain directors, officers and employees, and to maintain good relations with customers and depositors.

Second, that MCorp and its subsidiaries will, subject to the exercise of fiduciary responsibilities or what is believed by MCorp to be in the best interest of the company, use all reasonable efforts to refrain from seeking voluntary bankruptcy and to prevent an involuntary bankruptcy proceeding.

Third, that MCorp will use all reasonable efforts to assure that traditional inter-bank relationships, in particular inter-bank funding, among the subsidiary banks of MCorp be maintained generally at their current levels.

Finally, that MCorp allow potential investors selected by us to have free and open access to the books, records and personnel of MCorp and the banks. We will agree to appropriate confidentiality restraints on the material gathered.

The Office of the Comptroller of the Currency and the Federal Reserve Board have advised us that upon execution of this agreement by MCorp and its subsidiary banks, they will agree to a limited suspension of certain of their regulatory actions. The OCC will agree that with respect to its Notice of Intent to Issue Capital Directives, no response will be required for forty-eight hours following delivery of an additional letter from the OCC requiring such response. The OCC has further agreed that personal liability will not be pursued against the officers and directors of the subsidiary banks with respect to these Capital Directives. The Federal Reserve Board will agree to defer the time of submission of the report of capital injections required by its October 24, 1988 Temporary Order until five days following notice to MCorp by the Federal Reserve Board. Both agencies reserve their rights to fulfill all other regulatory responsibilities as to the banks and the holding company, including the initiation of other enforcement actions if circumstances require.

Further, as part of our evaluation of various options, the OCC, the Federal Reserve, and the FDIC will con-

tinue to monitor the situation at the various MBanks and will continue to evaluate assets and the financial condition of the banks.

We cannot provide any assurance that the FDIC will ultimately approve your 13(c) request for assistance.

We understand that this letter is not legally binding on either party, but represents our mutual expectations regarding the matters set forth herein, and can be terminated by either party at any time without prejudice.

Sincerely,

/s/ William Roelle
WILLIAM ROELLE
Associate Director

The undersigned acknowledge(s) and agree(s) to pursue an assistance transaction with the FDIC on the basis outlined above.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20951

November 7, 1988

John D. Hawke, Jr., Esq.
Arnold & Porter
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Hawke:

We understand that the FDIC and MCorp have agreed, subject to certain understandings, to begin negotiations on a proposal for federal financial assistance under section 13(c) of the Federal Deposit Insurance Act. In particular, MCorp has represented to the FDIC that as part of the proposal you have put forward to the FDIC you are prepared to use the resources of MCorp to support that company's subsidiary banks.

In view of the negotiations described above, including MCorp's proposal to support its subsidiary banks, and during the time that such negotiations continue, we are authorized to represent to you as follows:

1. The Board will defer the time for submission of the report of capital injections required by its October 26, 1988, Temporary Cease and Desist Order (the "Order") until five days following notice to MCorp by the Board. As noted in our letter of October 30, 1988, the Order does not require MCorp to take any affirmative action with respect to MCorp assets prior to the submission of the report called for by the Order.

2. The Board will agree with MCorp to postpone the administrative and any judicial proceeding under the Notice of Charges, Amended Notice of Charges, and Order for a period of thirty days from the scheduled date of such proceeding. Prior to the expiration of this thirty

day extension, the Board is prepared to discuss with MCorp additional extensions of thirty days if the negotiations between MCorp and the FDIC are still continuing. The Board will agree with MCorp to extend the time within which MCorp must file an answer to the Notice of Charges issued on October 19, 1988, from November 8 to November 11, 1988.

You should be aware that during the period of negotiations the Board may, if it deems such action to be necessary, initiate enforcement action with respect to any violations of law and unsafe or unsound practices, including the issuance of further Temporary Orders To Cease and Desist requiring MCorp to make immediate capital injections into subsidiary banks with capital deficiencies.

Sincerely,

/s/ Michael Bradfield
MICHAEL BRADFIELD

/s/ William Taylor
WILLIAM TAYLOR

UNITED STATES OF AMERICA
BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C.

No. 88-062-B-A2-HC

IN RE MCORP, DALLAS, TEXAS

[Filed: May 24, 1989]

SECOND AMENDED NOTICE OF CHARGES AND OF HEARING ISSUED PURSUANT TO THE FEDERAL DEPOSIT INSURANCE ACT, AS AMENDED, AND THE BANK HOLDING COMPANY ACT OF 1956, AS AMENDED

The Board of Governors of the Federal Reserve System (the "Board of Governors") has reasonable cause to believe that MCorp, Dallas, Texas ("MCorp"), a registered bank holding company, has engaged, is engaging and, unless restrained, will continue to engage in unsafe and unsound practices and violations of law and regulation in conducting the business of MCorp, and that, as a result of the unsafe and unsound practices and violations, the financial condition of MCorp and its subsidiary banks are likely to be adversely affected.

Accordingly, the Board of Governors hereby institutes this proceeding for the purpose of determining whether an appropriate order to cease and desist should be issued against MCorp and issues this second amended Notice of

Charges and of Hearing (the "Second Amended Notice"), which amends the Notice of Charges and of Hearing issued against MCorp on October 19, 1988 and the Amended Notice of Charges and of Hearing issued against MCorp on October 26, 1988 (the "Amended Notice"), in implementation thereof pursuant to the provisions of sections 8(b)(1) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "Act") (12 U.S.C. 1818(b)(1) and (3)), section 5(b) of the Bank Holding Company Act of 1956, as amended (the "BHC Act") (12 U.S.C. 1844(b)) and the Board of Governors' Rules of Practice for Hearings (12 CFR Part 263).

In support of this Second Amended Notice, the Board of Governors alleges the following:

1. MCorp, a corporation existing and doing business under the laws of the State of Delaware, is, and has been at all times pertinent to the charges herein, a registered bank holding company. MCorp, therefore is, and has been at all times pertinent to the charges herein, subject to the Act (12 U.S.C. 1818 *et seq.*), the BHC Act (12 U.S.C. 1841 *et seq.*) and the rules and regulations of the Board of Governors (12 CFR 201 *et seq.*).

2. Until March 29, 1989, MCorp owned 25 subsidiary banks and 17 active nonbank subsidiaries, and, by virtue of such ownership, controlled the affairs and management of the 25 subsidiary banks and the nonbank subsidiaries. All of the subsidiary banks were national banks subject to the primary regulatory jurisdiction of the Office of the Comptroller of the Currency (the "OCC").

3. On November 4, 1986, MCorp entered into a Memorandum of Understanding (the "MOU") with the Federal Reserve Bank of Dallas (the "Reserve Bank"), which provided, *inter alia*, that "MCorp will take all necessary steps to ensure that adequate capital positions are maintained at the holding company and at each of its subsidiary banks and nonbank subsidiaries".

4. The Minimum Capital Ratios Regulation of the OCC (12 CFR Part 3) provides that the minimally ac-

ceptable ratio of primary capital to total assets for national banking institutions is 5.5 percent unless a higher minimum capital ratio requirement is established for a bank in light of the particular circumstances of that bank.

5. On March 28 and 29, 1989, following a series of events, 20 of MCorp's 25 subsidiary banks were declared insolvent and closed by the OCC. In particular:

(a) As of September 30, 1988, 22 of MCorp's then existing 25 bank subsidiaries had primary capital ratios below 5.5 percent of their total assets.

(b) On October 7, 1988, MCorp requested that the Federal Deposit Insurance Corporation provide MCorp with federal financial assistance, pursuant to section 13 (c) of the Act (12 U.S.C. 1823(c)). The Federal Deposit Insurance Corporation subsequently informed MCorp, as a condition to proceeding with such assistance, MCorp should immediately use its available assets to support its subsidiary banks.

(c) On October 24, 1988, MCorp announced that the board of directors of MCorp declared a moratorium on the payment of principal and interest on all parent company public and privately placed indebtedness for borrowed money.

(d) As of October 26, 1988, the Board of Governors had reasonable cause to believe that, based on the volume of classified assets at the 25 MCorp banks, their earnings and other related factors, some of those 25 banks were in danger of failing in the absence of increases in their capital accounts. On October 26, 1988, the Board of Governors initiated a cease and desist proceeding and issued a temporary order to cease and desist against MCorp designed to ensure that MCorp takes such actions that were necessary to provide capital support to its banks that were in need of additional capital.

(e) On or about October 27, 1988, the OCC issued to 18 of the MCorp banks notices of its intent to issue capital directives, pursuant to the International Lending

Supervision Act of 1983 (12 U.S.C. 3907 *et seq.*), that (1) required these banks to attain primary capital ratios of 4.5 percent as an interim requirement, and (2) provided these banks with a period of two days to respond to the OCC's notices.

(f) On or about November 6, 1988, negotiations were commenced between MCorp and the Federal Deposit Insurance Corporation for purposes of considering a proposal by MCorp to recapitalize its subsidiary banks with the aid of federal financial assistance on an open bank basis. In consideration of the plan, MCorp and the Board of Governors agreed to postpone the hearing directed by the Amended Notice and to defer the submission of the report of financial assistance required by the temporary order issued on October 26, until 5 days after notice to MCorp by the Board of Governors.

(g) On March 21, 1989, involuntary bankruptcy proceedings were instituted against MCorp in New York.

(h) On March 28, 1989, the Federal Deposit Insurance Corporation decided not to provide any open bank assistance to any of MCorp's subsidiary banks.

(i) On March 28, 1989, the OCC found MBank-Dallas, one of MCorp's subsidiary banks, to no longer be viable as a privately funded institution.

(j) As a result of the OCC's finding and other factors, the Reserve Bank decided not to extend additional credit to MBank Dallas and demanded repayment of MBank Dallas' demand note.

(k) Despite repeated assurances of MCorp management that MCorp would act to support its then 25 subsidiary banks and the provisions of the MOU with the Reserve Bank described in paragraph 3 hereof, MCorp has failed to meet the capital needs of its subsidiary banks. Twenty of MCorp's 25 banks were declared insolvent and were closed by the OCC on March 28 and 29, 1989.

6. As of the date of this Second Amended Notice, MCorp continues to own five subsidiary banks—MBank

El Paso, N.A., El Paso, Texas, MBank Corpus Christi, N.A., Corpus Christi, Texas ("MBank Corpus"), MBank Waco, N.A., Waco, Texas ("MBank Waco"), MBank Brownsville, N.A., Brownsville, Texas and MBank New Braunfels, N.A., New Braunfels, Texas ("MBank New Braunfels"). MCorp, by virtue of such ownership of these five subsidary banks (referred to herein collectively as the "Subsidiary Banks"), controls the affairs and management of the Subsidiary Banks. All of the Subsidiary Banks are subject to the primary regulatory jurisdiction of the OCC.

7. The remaining Subsidiary Banks continue to have inadequate levels of capital protection, and they are suffering losses and erosions of their deposit bases. In particular:

(a) As of the date of this Second Amended Notice, internal reports and call report statements generated by each of the Subsidiary Banks indicate that three of the Subsidiary Banks have stated primary capital ratios below 5.5 percent of their total assets, the minimum ratio established for such banks by the regulations of the OCC: MBank Corpus (4.72 percent), MBank Waco (3.54 percent), and MBank New Braunfels (1.38 percent). In order to increase the stated primary capital ratios of these banks to the minimum level established by the OCC regulations, an additional capital investment of approximately $21 million would be necessary.

(b) The Subsidiary Banks are each experiencing deposit erosion and four of the five are incurring losses.

(c) The Board of Governors has reasonable cause to believe that, based on the volume of classified assets at the Subsidiary Banks, their earnings and other related factors, some of the Subsidiary Banks are in danger of failing in the absence of increases in their capital accounts.

(d) On May 1, 1989, the OCC sent letters to each of MCorp's Subsidiary Banks. The letters requested that

the Subsidiary Banks each submit to the OCC withtin 30 days of their receipt of these letters capital plans designed to increase and/or maintain the capital of the Subsidiary Banks at appropritae regulatory standards. The Board of Governors has reasonable cause to believe that the Subsidiary Banks have no independent, outside sources of capital other than from their parent bank holding company, MCorp.

8. (a) As of the date of this Second Amended Notice, the Board of Governors has reason to believe that MCorp has sufficient assets to make additional investments in the capital accounts of the Subsidiary Banks to bring them to the minimum capital levels described in paragraph 4 hereof.

(b) The Board of Governors has reason to believe that the additional investment by MCorp in its wholly owned Subsidiary Banks would cause the Subsidiary Banks to remain as valuable assets of MCorp, thereby providing MCorp with a potential source of future income.

9. Given MCorp's past failure to support adequately its subsidiary banks, its failure to comply with the capital provision of the MOU, and representations by MCorp management to the staff of the Reserve Bank and the Board of Governors, the Board of Governors has reasonable cause to believe that MCorp will not make all reasonable efforts to assure that the Subsidiary Banks have levels of capital protection at or above the standards set by the Subsidiary Banks' primary federal regulator. In particular:

(a)(1) Section 5(b) of the BHC Act (12 U.S.C. 1844(b)) provides that:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purpose of this chapter [the BHC Act] and prevent evasions thereof.

(2) Section 225.4(a)(1) of Regulation Y of the Board of Governors (12 CFR 225.4(a)(1)) provides that:

> A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(b) The Board of Governors' Policy Statement on the responsibility of bank holding companies to act as sources of strength to their subsidiary banks provides that a bank holding company's failure to provide assistance to a subsidiary bank in weakened or failing condition when the holding company is in a position to provide the support will be viewed as an unsafe and unsound banking practice and a violation of Regulation Y.

(c) By failing to make all reasonable efforts to assure that the capital of its subsidiary banks, including the five Subsidiary Banks described in paragraph 6 hereof, complies with minimum regulatory standards as the financial conditions of such banks have deteriorated, MCorp and its management improperly limited the company's ability to enhance the banks' capital and, thereby, threatened and continue to threaten the continued financial viability of the Subsidiary Banks. Thus, MCorp and its management have engaged in an unsafe and unsound practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the capital provision of the MOU, and are continuing such practices and violations, that adversely affect MCorp's condition and the conditions of its subsidiary banks and that limit MCorp's ability to serve as a source of financial strength to the banks.

(d) The Board of Governors has reasonable cause to believe that MCorp and its management will fail to use its available resources to prevent the continued deterioration of the subsidiary Banks and thereby will engage in an unsafe and unsound banking practice, a violation of section 225.4(a)(1) of Regulation Y of the Board of Governors, and a violation of the MOU that would adversely affect MCorp's condition and the conditions of the Subsidiary Banks and that would limit MCorp's ability to serve as source of financial strength to the Subsidiary Banks.

10. MCorp and its management have failed to operate MCorp and the subsidiary banks in a safe, sound and lawful manner as set forth in paragraphs 3, 4, 5, 6, 7, and 8 hereof.

11. On March 31, 1989, MCorp and two of its nonbank subsidiaries filed petitions for voluntary bankruptcy pursuant to Chapter 11 of the Federal Bankruptcy Code. MCorp has initiated an adversary proceeding in bankruptcy court against the Board seeking preliminary and permanent injunctive relief preventing the Board from reactivating these proceedings. As of the date of this notice, no relief has been granted. The Board of Governors is of the opinion that the commencement and continuation of the proceedings against MCorp instituted by this Second Amended Notice would not be effected by the provisions of the Federal Bankruptcy Code.

12. Notice is hereby given that a hearing will be held on July 12, 1989, at the Federal Reserve Bank of Dallas for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the Act and the BHC Act requiring MCorp to cease and desist from the unsafe or unsound practices and violations of law and regulation herein specified or to take affirmative action as may be appropriate under the circumstances of this matter, including a requirement that MCorp immediately make such additional investments in its Subsidiary Banks as is necessary to assure that those banks meet and will continue to meet the minimum capital standards prescribed by the applicable capital adequacy regulations or guidelines of the OCC or such higher

minimum capital requirements as the OCC, in its discretion, deems necessary or appropriate for such bank pursuant to sections 3.9-3.13 of the OCC's minimum capital regulations. 12 C.F.R. 3.9-3.13.

13. The hearing referred to in paragraph 12 hereof shall be held before an administrative law judge to be appointed by the United States Office of Personnel Management pursuant to section 3344 of Title 5 of the United States Code (5 U.S.C. 3344). The hearing shall be private, unless the Board of Governors shall determine that a public hearing is necessary to protect the public interests, and in all other aspects shall be conducted in compliance with the provision of the Act and the Board of Governors' Rules of Practice for Hearings.

14. Authority is hereby delegated to the Secretary of the Board of Governors to designate the time and place and presiding officer for any hearing that may be conducted on this Second Amended Notice and take any and all actions that the presiding officer would be authorized to take under the Board of Governors' Rules of Practice for Hearings with respect to this Second Amended Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the United States Office of Personnel Management and by the Secretary of the Board of Governors as provided herein.

15. The provisions of this Second Amended Notice do not supersede, modify, or, any manner, affect the provisions of the Notice of Charges and of Hearing issued against MCorp and MCorp Management, Dallas, Texas by the Board of Governors on March 30, 1989, or the status of the temporary orders issued on October 19 and 26, 1988.

16. MCorp is hereby directed to file an answer to this Second Amended Notice within 20 days of service of this Second Amended Notice as provided by section 263.5 (a) of the Rules of Practice for Hearings of the Board of the Board of Governors (12 CFR 263.5(a)). As pro-

vided in section 263.5(d) of the Rules of Practice for Hearings of the Board of Governors (12 CFR 263.5 (d)), the failure of MCorp to file an answer required by this Second Amended Notice within the time provided herein shall constitute a waiver of MCorp's right to appear and contest the allegations of this Second Amended Notice and authorization for the presiding officer, without further notice to MCorp, to find the facts to be as alleged in this Second Amended Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

Dated at Washington, D.C., this *24th* day of May, 1989.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos.
89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC, ETC.,
MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and MCORP
MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 2, 1989]

OFFER OF PROOF IN SUPPORT OF EMERGENCY MOTION FOR PRELIMINARY INJUNCTION

MCORP, MCORP FINANCIAL, INC. and MCORP MANAGEMENT hereby make the following offer of proof in support of their Emergency Motion for a Preliminary Injunction in the above-captioned adversary proceeding:

Peter Bartholow, Chief Financial Officer and Group Chairman—Planning and Finance of MCorp and MCorp

Management and President and a Director of MCorp Financial, Inc. ("MCorp Financial") will testify to the following facts:

1. Prior to March 28, 1989, MCorp and MCorp Financial, its wholly owned subsidiary, were holding companies for MCorp Management, 25 MBanks, MVestment (itself a holding company for MTrust Corp., N.A., a trust company and related investment advisory entities), and approximately 17 non-bank subsidiaries. MCorp Management supplied management, financial and advisory services to MCorp, MCorp Financial and their other bank and non-bank subsidiaries.

2. There are no paid employees of either MCorp or MCorp Financial. Prior to September 30, 1988, MCorp Management employed approximately 350 persons, most of whom spent substantially all of their time performing services related to the 25 MBanks including audit, loan review, accounting, tax, financial planning, investment, and human resources services. On October 1, 1988, approximately 340 of the 350 employees of MCorp Management were transferred from its payroll to the payroll of certain MBanks. Prior to September 30, 1988, MCorp Management charged the MBanks and other entities in the MCorp family for the services rendered to them by MCorp Management personnel. After October 1, 1988, the MBanks to which the former MCorp Management employees were transferred charged MCorp, MCorp Financial and MCorp Management for services rendered by the transferred employees to those entities. As a result, there was no substantial economic impact on MCorp Management or the MBanks by virue of thè transfer of personnel that was effected on October 1, 1988.

3. MCorp began efforts to recapitalize MCorp, MCorp Financial and the MBanks in the late spring or early summer of 1988. Those efforts included discussions with the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("Comp-

troller") and staff of the Board of Governors of the Federal Reserve System of the United States of America ("Board") (collectively the "Regulators").

4. On October 7, 1988, MCorp submitted to the FDIC a formal written proposal for the comprehensive recapitalization of the MBanks and a restructure of the debt and equity of MCorp and MCorp Financial. That proposal contemplated that all of the financial assets and resources of MCorp, then having a value of approximately $360 million, would be dedicated to the financial support of the MBanks; that MCorp would raise between $350 and $400 million of new capital from private sources that would be dedicated to the comprehensive restructuring and recapitalization of MCorp and the M-Banks; and that substantial financial assistance for the MBanks would be made available and committed by the FDIC. The elements of that proposal had been discussed with the FDIC, the Comptroller and the Board over a period of several months prior to October 7, 1988.

5. Within two weeks after MCorp submitted its proposal to the FDIC, the Board served MCorp with a Notice of Charges dated October 19, 1988 and two temporary cases and desist orders, each dated October 19, 1988 and Exhibit 2 is the two temporary cease and desist orders.

6. The first cease and desist order prohibited MCorp from paying dividends on its common and preferred stock. MCorp had not paid dividends on its common stock since the last quarter of 1986. Although it had continued to pay dividends on its preferred stock through the third quarter of 1988, MCorp had advised the Regulators that MCorp's board of directors would consider, at a meeting scheduled to be held on October 24, 1988, the discontinuance of dividends on its preferred stock in order to husband its assets for use in connection with the proposed recapitalization plan submitted to the FDIC. MCorp's management also indicated that its board of directors would consider the declaration of a moratorium on the payment of principal of and interest on

all of McCorp's borrowed money debt. Furthermore, prior to October 19, 1988, MCorp advised the Regulators that MCorp was prohibited from the payment of preferred stock dividends because of certain covenants in MCorp's debt agreements.

7. The second temporary cease and desist order prohibited MCorp from entering into any transaction or taking any action that would result in the dissipation of its assets. Specifically exempted from the restraints of the second temporary cease and desist order were (a) the continued payment of principal and interest on MCorp's borrowed money debt, (b) the payment of salaries to employees (but not bonuses) and (c) the payment for goods and services obtained by MCorp pursuant to agreements entered into in the ordinary course prior to October 19, 1988. Shortly after the second temporary cease and desist order was issued, MCorp complained to the Board that the second temporary cease and desist order was phrased in such a manner that it did not know which of its obligations it could pay without violating that temporary cease and desist order and sought relief from and clarification by the Board on that issue. The only relief offered by the Board was to require MCorp to seek permission of the Board for each payment MCorp believed might be prohibited by the second temporary cease and desist order.

8. On October 24, 1988, MCorp's board of directors suspended the declaration and payment of dividends on its preferred stock and declared a moratorium on the payment of all principal of and interest on all borrowed money debt of MCorp, effective as of October 21, 1988.

9. Without warning from the Board and while the discussions about the second temporary cease and desist order were being carried on by representatives of the Board and MCorp, the Board issued an Amended Notice of Charges and a third temporary cease and desist order, Exhibits 3 and 4, respectively, on October 26, 1988. The Amended Notice of Charges informed MCorp that, on the

following day, October 27, 1988, the Comptroller would issue to 18 of the MBanks, notices of intent to issue capital directives to the 18 banks requiring those banks to submit plans to the Comptroller to raise additional capital. The third temporary cease and desist order required MCorp to prepare to infuse its financial assets, approximating $360 million in value, into the 18 MBanks and to submit to the Board, within 15 days, a plan stating the assets to be contributed as capital to each of the 18 MBanks, and the identity of each such MBank. The Comptroller issued such notices of intent to 18 of the MBanks on October 28, 1988.

10. After the receipt of the third temporary cease and desist order, MCorp advised the Board and the other Regulators that it would not comply with that order or any other order requiring it to downstream its assets into the undercaptialized MBanks because such action would have constituted a waste of MCorp's assets, fraudulent conveyances of those assets, and a violation of Delaware law subjecting MCorp and its officers and directors to personal liability unless, as part of the same transaction, the FDIC would provide substantial financial assistance to the MBanks and MCorp was able to effect a restructure of its debt and equity as part of a global transaction. MCorp requested the FDIC to commit to provide open bank assistance to the MBanks if MCorp made the capital infusions referred to in the Amended Notice of Charges, and the FDIC refused to make such a commitment at that time or to assure MCorp that it would make such a commitment at any time in the future.

11. Within ten days after the receipt of the third temporary cease and desist order, MCorp commenced an action against the Board in the United States District Court for the Northern District of Texas, Dallas Division, seeking an order suspending or rescinding the three temporary cease and desist orders issued by the Board. Exhibit 7 is the First Amended Complaint in that action.

12. During this period, the Board of Directors of MCorp received a letter dated October 25, 1988, Exhibit 5, threatening MCorp with legal action, including the filing of an involuntary chapter 11 petition against MCorp, if MCorp made or attempted to make capital contributions of its assets to the MBanks. In addition, during early November, 1988, one of MCorp's creditors, Charlifco filed an action against MCorp in the Chancery Court for the State of Delaware seeking an injunction against MCorp is [*sic*] making capital contributions to the MBanks. The complaint in that action is Exhibit 6.

13. Prior to November 6, 1988, MCorp advised all of the Regulators that if it was compelled to downstream substantial assets into the MBanks, as contemplated by the Amended Notice of Charges, MCorp would be compelled to seek relief pursuant to chapter 11 of the Bankruptcy Code. As a result of intensive negotiations with the Regulators, on November 6, 1988, MCorp and the FDIC entered into an agreement, Exhibit 8, that is referred to as a standstill agreement. On the following day, MCorp entered into a standstill agreement with the 18 MBanks to which the notices of intent to issue capital directives had been issued.

14. Under the terms of the standstill agreement with the FDIC, the FDIC acknowledged that MCorp's recapitalization proposal of October 7, 1988 merited consideration and further discussion and agreed to commence negotiations with MCorp immediately. The FDIC advised MCorp that it would solicit bids from other parties to acquire the MBanks or MCorp and the MBanks, and MCorp agreed that it would make available its books, records and personnel and would use its best efforts to make available the books, records and personnel of the MBanks to all prospective bidders qualified and approved by the FDIC. MCorp also agreed to use all reasonable efforts to maintain intact the then existing funding arrangements between and among the MBanks. Finally, MCorp agreed that it would not file a voluntary chapter 11 case and would use reasonable efforts to prevent others

from filing an involuntary chapter 11 case, provided that such actions were consistent with MCorp's fiduciary duties and obligations to its creditors and shareholders.

15. The standstill agreement between MCorp and the Board provided that the Board would take no further action with respect to the third temporary cease and desist order, the Amended Notice of Charges, and MCorp and the Board agreed that the pending action in the United States District Court for the Northern District of Texas against the Board would be suspended while the FDIC negotiated MCorp's recapitalization plan and other bidders were given an opportunity to conduct due diligence investigations of MCorp and the MBanks and bids were solicited.

16. During the same period, the Comptroller agreed that the MBanks that had received notices of intent to issue capital directives would not have to respond to those notices and further agreed that the officers and directors of those banks would not be subject to civil money penalties for failure to raise additional capital.

17. The FDIC standstill agreement contemplated that the due diligence and bidding process would take approximately ten weeks and that the FDIC would make a decision on which proposal to accept within a period of approximately two weeks after the ten week period expired.

18. Between October 19, 1988 and March 28, 1989, MCorp complied in all respects with the provisions of the first two temporary cease and desist orders. Furthermore, MCorp has complied with those orders right up to the present date. The Board has never complained to MCorp that it did not comply with those orders.

19. Between November 6, 1988 and March 28, 1989, MCorp complied in all respects with its obligations under under the standstill agreements with the Board, the Comptroller and the FDIC and none of them complained to MCorp that it failed to comply with those obligations.

20. The FDIC failed to conduct any meaningful, substantive negotiations of its recapitalization proposal dated October 7, 1988, between October 7, 1988 and March 28, 1989. MCorp made numerous attempts to conduct meaningful negotiations with the FDIC, but on each occasion was advised by the FDIC that the FDIC was not yet prepared to discuss the development or terms of a comprehensive recapitalization plan.

21. On March 24, 1989, MCorp learned for the first time that an involuntary chapter 7 petition had been filed against it in the United States Bankruptcy Court for the Southern District of New York on March 21, 1989. MCorp learned of that filing by a telephone call from a reporter for the *Wall Street Journal.* That day was Good Friday and I had accompanied my family to visit friends in East Texas. Gene H. Bishop, Chairman of the Board and Chief Executive Officer of MCorp also was out of the city with his family.

22. Over the weekend, Mr. Bishop, I, other senior officers of MCorp and its regular corporate counsel and bankruptcy counsel were called and we met in Dallas on Sunday, March 26, 1989. When we returned to Dallas, we immediately contacted the senior officers of each of the MBanks to notify them of the filing of the involuntary petition and to make plans to deal with the concerns that undoubtedly would be raised by customers, depositors and borrowers of the MBanks when the news of the involntary chapter 7 filing became public on Monday morning, March 27, 1989.

23. On Sunday, March 26, we also contacted Robert Clarke, the Comptroller, to advise him of the filing of the involuntary chapter 7 petition. We did not immediately contact the FDIC or the Board because Mr. Clarke requested that we give him an opportunity to advise the FDIC and the Board of the filing of the involuntary petition. By late that evening, we were in direct communication with the Board and the Comptroller to discuss the filing of the involuntary petition and the plans and

preparations we and the MBanks were making to deal with the situation.

24. Later on Tuesday, March 28, 1989, we learned from officials of the MBanks and the Comptroller that teams of personnel from the FDIC and the Comptroller were arriving at all of the MBanks. Within a matter of hours, we were advised that the Comptroller had determined to declare MBank Dallas and MBank Houston insolvent. Over the night of March 28 and early in the morning of March 29, the Comptroller declared 18 additional MBanks insolvent and closed them, appointing the FDIC as receiver of all 20 of the closed MBanks.

25. The 20 MBanks closed by the Comptroller on the night of March 28-29, 1989 included the MBanks previously referred to in the Amended Notice of Charges dated October 26, 1988 which hade been the recipients of the Comptroller's Notice of Intent to Issue Capital Directives, except for MBank New Braunfels. MBank New Braunfels was not declared insolvent or closed.

26. As a consequence of the actions of the Comptroller on the night of March 28-29, 1988, the charters of the 20 MBanks declared insolvent were revoked, those banks no longer exist, and those banks are no longer owned or controlled by MCorp or MCorp Financial. Certain of the assets and all of the deposit liabilities, liabilities to customers, liabilities to creditors of the closed MBanks, except for their liabilities to their parents and affiliates, were transferred to and assumed by the Deposit Insurance Bridge Bank, a newly chartered national bank that is wholly owned and controlled by the FDIC.

27. A copy of the joint press release issued by the Comptroller and the FDIC on March 29, 1989, is Exhibit 10. As to MBank New Braunfels, it and four other MBanks continue to be owned and controlled by MCorp. However, in recent call reports filed with the Comptroller by MBank New Braunfels, its primary capital ratio, on a risk adjusted basis, is in excess of the minimum capital requirements of the Comptroller. Accordingly, MCorp is

of the view that the Amended Notice of Charges dated October 26, 1988 and the third temporary cease and desist order dated the same day are moot because the MBanks into which the Board attempted to require MCorp to infuse as assets, other than MBank New Braunfels, no longer exist, and MBank New Braunfels has capital in excess of the minimum capital requirements of the Comptroller on a risk-adjusted basis.

28. On or immediately after March 27, 1989, MCorp announced publicly that it intended to convert the involuntary chapter 7 petition that was filed in New York to a voluntary chapter 11 case and to transfer that chapter 11 case from the Southern District of New York to the United States Bankruptcy Court for the Southern District of Texas, Houston Division. It also announced that MCorp Financial and MCorp Management intended to file voluntary chapter 11 petitions in the Southern District of Texas. These public announcements also stated that the filing of the chapter 11 petitions of the three companies would not have any effect on the business of the five remaining MBanks and MTrust Corp., their depositors, customers or other creditors.

29. As previously indicated, on March 28, 1989, MCorp was still in compliance with all of its obligations pursuant to the standstill agreements reached with the Regulators.

30. Nevertheless, on March 30, 1989, the Board issued a new Notice of Charges, Exhibit 12, to MCorp and MCorp Management. That Notice of Charges alleged that MCorp and MCorp Management had engaged, were engaging and, unless restrained, would continue to engage in violations of Section 23A of the Federal Reserve Act in that MCorp and MCorp Management caused MBank Houston and MBank Dallas (as successor by merger to MBank Preston) to extend to Corp Management, unlawful, unsecured extensions of credit.

31. At the time of the issuance of the March Notice of Charges, both MBank Houston and MBank Dallas al-

ready had been closed. The transaction on which the March Notice of Charges is based arose out of transactions that commenced in August, 1985 when MBank USA was organized to purchase from MBank Houston and MBank Preston the assets of the credit card portfolios of those banks. MBank USA was a wholly-owned subsidiary of MNet, itself a wholly-owned subsidiary of MCorp Financial.

32. In that transaction, MBank USA paid MBank Preston and MBank Houston an amount equal to the amount owed by customers on their credit card accounts as of the date of sale, plus a premium for the going concern value of the credit card operations, and further agreed to pay, as "Additional Contingent Fees" the lesser of a fixed sum or a sum equal to a percentage of MBank USA's monthly net income until the earlier of the payment of a specified amount to each of those banks or December 31, 1993. Exhibits 13 and 14 are letter agreements between MBank USA and MBank Houston dated August 1, 1985, and MBank USA and MBank Preston, dated October 9, 1985, embodying the Additional Contingent Fee arrangements.

33. MBank Houston and MBank Preston agreed to sell federal funds to MBank USA in order to provide it with working capital with which to conduct and expand its credit card operations, in exchange for which MBank USA agreed to pay interest on the federal funds so provided to MBank Houston and MBank Preston.

34. In the Fall of 1986, MCorp agreed to sell the stock of MNet to Lomas & Nettleton Financial Corporation ("Lomas") for approximately $300 million in cash, promissory notes of Lomas, and two series of Preferred Stock of Lomas, all pursuant to a Stock Purchase Agreement dated as of November 16, 1986. However, as part of that agreement, Lomas required MBank USA to discontinue its obligation to pay a portion of its net profits to MBank Houston and MBank Preston as Additional Contingent Fees.

35. To substitute for the Additional Contingent Fee arrangement previously agreed to by MBank USA, MCorp Management agreed to enter into Release Agreements with MBank Preston and MBank Houston dated December 30, 1986, that are Exhibits 15 and 16. Under those Release Agreements, MCorp Management agreed to pay to MBank Preston and MBank Houston additional contingent payments in an amount equal to the lesser of (a) the sum of interest and dividends actually received by MCorp Management on the Lomas notes and Preferred Stock or (b) quarterly cash payments aggregating $2,853,000 and MBank Houston and MBank Preston agreed to release MBank USA from the Additional Contingent Fee profit sharing arrangement provided for in Exhibits 13 and 14. Consequently, the original Additional Contingent Fee obligations were replaced by new contingent payment obligations geared to the interest and principal payments on the Lomas notes and Preferred Stock.

36. The Board was concerned about certain aspects of the transaction between MCorp and Lomas at or about the time that transaction occurred. The transaction was reviewed with representatives of the Board by members of the management of MCorp. The Board did not criticize the MNet transaction or MCorp Management's role in that transaction either in December of 1986 or thereafter until March, 1989.

37. Although the Board examined MCorp and its subsidaries on numerous occasions between September 30, 1986 and January, 1989, the Board never criticized or questioned the MNet transaction until the end of February or early March, 1989.

38. Furthermore, the Comptroller, as primary regulator of MBank Houston and MBank Dallas, conducted numerous examinations of those institutions and other MBanks between March 31, 1986 and January, 1989. The Comptroller has never criticized or raised questions

about the MNet transaction or MCorp Management's obligations to MBank Dallas or MBank Houston.

39. When the March Notice of Charges was issued to MCorp and MCorp Management on March 30, no money was then due from MCorp Management to Bank Dallas or Bank Houston on account of the contingent payment obligation assumed by MCorp Management pursuant to Exhibits 15 and 16.

40. Prior thereto, MCorp Management had made certain of these contingent payments to MBank Dallas and MBank Houston for 1987. However, in contemplation of the merger of MBank Preston into MBank Houston and because MBank Dallas and MBank Houston were obligated to MCorp Management for financial support and management services in amounts substantially in excess of the contingent payments then due for MCorp Management to the Banks, MCorp Management did not make contingent payments to MBank Dallas and MBank Houston for 1988 and, in effect, set them off against the payments due from the banks. At this time, the receivership estates of MBank Dallas and MBank Houston are indebted to MCorp Management because of financial support and management services provided to those banks by MCorp Management, after taking into account all contingent payments due from MCorp Management to those banks.

41. MCorp Management and MCorp dispute the charges contained in the March Notice of Charges that is Exhibit 17, preserving all rights with respect to the automatic stay under Section 362 of the Bankruptcy Code. MCorp and MCorp Management never borrowed money from MBank Houston or MBank Preston (as predecessor to MBank Dallas) in connection with the MNet or MBank USA transaction that occurred in December 1986. Nor did MCorp or MCorp Management receive an extention of credit from MBank Preston or Bank Houston in connection with that transaction. In fact, MCorp Management never received any consideration of any kind from either MBank Houston or MBank

Preston in connection with the 1986 MNet transaction with Lomas or as a result of that transaction. In the 1986 transaction pursuant to which MBank USA and MNet were sold to Lomas, both banks released MBank USA from any continuing obligation under the Additional Contingent Fee agreement.

42. As Chief Financial Officer of MCorp since 1980 and as Chief Financial Officer of MCorp Management since 1984, Mr. Bartholow will testify that neither of those entities has ever caused MBank Preston, MBank Dallas or MBank Houston to violate Section 23A of the Federal Reserve Act. Nor did they cause any other MBank now in existence or closed on March 28 to violate Section 23A. It is not the intention of MCorp, MCorp Financial or MCorp Management to violate or cause any of the five remaining MBanks to violate Section 23A and they are well aware of their obligations to comply with all existing banking and other regulatory statutes and regulations.

43. If this Court fails to enjoin the continuation of the administrative proceedings that have been initiated by the March Notice of Charges, MCorp and MCorp Management will be compelled to defend those charges because they believe they are without merit. The defense of those charges will have a significant impact on the business and affairs of MCorp and MCorp Management. As of this date, MCorp, MCorp Financial and MCorp Management have assets consisting of financial assets with a value of approximately $350 million, five remaining Banks, MVestment and several non-bank subsidiaries. The approximate total value of the assets of the debtors is about $500 million. The indebtedness of those entities is approximately $500 million to $525 million on account of debt for money borrowed, including interest to March 31, 1989. There are other contingent liabilities of the Debtors as well as disputed claims against the Debtors.

44. It is the intention of MCorp to reorganize around the nucleus of the $500 million of assets, including the

five remaining MBanks. Steps already have been taken to begin that effort. Those steps include the preliminary development of a business plan that will form the nucleus and cornerstone of a plan of reorganization for the Debtors.

45. MCorp Management today employs approximately 32 people, 8 of whom are considered management level employees. The remaining employees are secretarial, clerical and administrative support personnel. The efforts to reorganize MCorp are being carried on by the eight management level employees. They also have responsibility to supervise and manage the five remaining MBanks, the trust and advisory businesses owned by MVestment and MTrust Corp, the non-bank subsidiaries, and the financial assets.

46. In addition, those persons are responsible for the conduct of litigation brought by MCorp against the Comptroller and the FDIC that is pending in the United States District Court for the Northern District of Texas, and that is described in the First Amended Complaint that is Exhibit 11. In addition, they are the people who have put together all of the schedules, statements of affairs and lists of executory contracts of the debtors filed with the Bankruptcy Court, have prepared and will prepare the reports required by the United States Trustee, and have met and will meet with and provide significant quantities of information to the creditors' committee. They are also responsible for providing information to counsel for the Debtors in order to prepare applications that are made to the Bankruptcy Court in the chapter 11 cases. Virtually all actions relating to the assets and businesses of the three Debtors that are outside the ordinary course of business, that relate to the retention of professionals, the sale or disposition of assets, the rejection of executory contracts, and all other activities requiring approval of the Bankruptcy Court, are initiated by the eight management level personnel who have to provide the necessary information to coun-

sel. They then review and approve applications to the Court and other documents that are prepared by counsel.

47. If these persons are required to participate in the defense of the March Notice of Charges brought by the Board, their efforts with respect to the other activities described above will be sidetracked and the reorganization effort will be impaired and delayed significantly.

48. The Board has advised the Administrative Law Judge appointed to determine the charges brought by the March Notice of Charges that it will require a four to six week period to take discovery in connection with the March Notice of Charges and approximately three days of trial time to present the Board's case. MCorp will have to undertake similar discovery efforts and MCorp's defense of the charges probably will consume a similar period of about three days. Furthermore, many of the books, records and other data concerning those transactions are not in the possession and control of MCorp or MCorp Management. They are in the possession and control of the Deposit Insurance Bridge Bank or the FDIC, as receiver of MBank Dallas and MBank Houston.

49. If MCorp is required to defend the charges in the October Notices of Charges that it believes are moot, similar efforts at discovery and trial time by the Board and MCorp will multiply the involvement of the management personnel of MCorp Management. In addition, in either case MCorp will be forced to incur substantial legal expense to its counsel for the defense of those charges.

50. If the proceedings in respect of the March Notice of Charges are not stayed, and should the Board prevail in establishing that MCorp Management is indebted to the receivership estates of MBank and MBank Houston, the Board will not be the beneficiary of any moneys that are required to be paid to those receivership estates. The beneficiary of any such claims will be the FDIC, as receiver or the Deposit Insurance Bridge Bank

if those claims have been assigned by the receiver to the Bridge Bank.

51. MCorp proposes that a far more efficient way to determine whether any moneys are owed by MCorp Management to MBank Dallas or MBank Houston or the receiver of those entities—or whether those entities are in fact indebted to MCorp Management, would be through the proof of claim process provided for by the Bankruptcy Code, and not through the administrative proceedings initiated by the Board. If those claims are established, they would, in any event, be paid pursuant to a confirmed plan of reorganization for MCorp Management and the other Debtors.

52. No useful purpose can be served by continuing a lengthy, burdensome and expensive regulatory proceeding to determine whether, in fact, the assumption of the contingent payment obligation by MCorp Management was a technical violation of Section 23A of the Federal Reserve Act. The creditors and stockholders of the Debtors should not be burdened by the Board's compelling MCorp and MCorp Management to be subjected to the regulatory proceedings relating to this three-year-old transaction.

Respectfully submitted,

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By /s/ Alan B. Miller
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Dated: Houston, Texas
June 2, 1989

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Jointly Admin. Chap. 11 Case Nos. 89-02312-H3-11, 89-02324-H5-11, and 89-02848-H2-11
Adversary Proc. No. 89-0298

IN RE: MCORP FINANCIAL, INC., ETC., MCORP MANAGEMENT, and MCORP, ETC., DEBTORS.

MCORP, MCORP FINANCIAL, INC., and MCORP MANAGEMENT, DEBTORS IN POSSESSION, PLAINTIFFS

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: June 2, 1989]

SUPPLEMENTARY OFFER OF PROOF RE MAY 24, 1989 NOTICE OF CHARGES

MCORP, MCORP FINANCIAL, INC. and MCORP MANAGEMENT hereby make the following offer of proof in support of their Emergency Motion for a Preliminary Injunction in the above-captioned adversary proceeding:

Peter Bartholow, Chief Financial Officer and Group Chairman—Planning and Finance of MCorp and MCorp Management and President and a Director of MCorp Financial, Inc. ("MCorp Financial") will testify to the following facts:

1. The May 24, 1989 Notice of Charges issued by the board to MCorp (the "May Notice of Charges") alleges that three of the remaining MBanks have primary capital ratios below 5.5 percent of their total assets, the minimum ratio established for such banks by regulations of the Comptroller, the primary regulator of the MBanks. The May Notice of Charges further alleges that to increase the primary capital ratio of those banks to the minimum level established by the Comptroller's regulations, additional capital investments of approximately $21 million would be necessary.

2. The May Notice of Charges also alleges that all five of the remaining MBanks are experiencing deposit erosion and four of the five remaining MBanks are incurring losses. MCorp disputes these allegations of the Board.

3. Although the May Notice of Charges alleges that the Comptroller sent letters to each of the remaining MBanks requesting that they submit to the Comptroller, the primary regulator, within thirty days of the receipt of such letters capital plans designed to increase and/or maintain the capital of such banks at appropriate levels, it fails to disclose that the Comptroller has extended to June 30, 1989, the time of such banks to submit those plans to the Comptroller.

4. MCorp alleges that the remaining MBanks will submit to the Comptroller, their primary regulator, plans to increase and/or maintain the capital of such banks at appropriate regulatory standards on or before June 30, 1989, unless the time to do so is further extended by the Comptroller.

5. Furthermore, prior to May 24, 1989, MCorp recognized the fact that three of the five remaining MBanks

may require additional capital even though there is no erosion of their deposits which has had an adverse effect on liquidity of the banks and those banks currently are operating and are expected to operate on a break even or profitable basis. To that end, on May 22, 1989, MCorp proposed to the Official Creditors' Committee appointed by the United States Trustee to serve in these chapter 11 cases, that it would make capital contributions to those MBanks provided that such capital contributions are approved by order of the Bankruptcy Court.

6. Prior to making the proposal to the Official Creditors' Committee, officers of MCorp met with the senior management of each of the three MBanks (and the other two MBanks) and obtained from them their respective operating plans, projected balance sheets, income statements and other projections relating to the operations of those MBanks for the balance of 1989 and for the year 1990. That information was furnished to the members of the Official Creditors' Committee on May 22, 1989.

7. The Official Creditors' Committee requested that MCorp provide additional information to the Official Creditors' Committee in respect of the proposed capital contributions and indicated that it would again consider MCorp's proposal at a meeting scheduled to be held on June 13, 1989. MCorp intends to comply with those requests of the Official Creditors' Committee.

8. The May Notice of Charges requires that MCorp answer those charges or or before June 13, 1989 and schedules a hearing on the May Notice of Charges for July 12, 1989, for the purpose of taking evidence on the charges specified therein.

9. MCorp has been advised by counsel that it may not make capital contributions to the five remaining MBanks without authorization to do so by order of the Bankruptcy Court granted pursuant to section 363(b) of the Bankruptcy Code. Otherwise, MCorp would be in violation of section 363(b) of the Bankruptcy Code and would be subject to sanctions by the Bankruptcy Court which

might include, among other things, the appointment of a trustee pursuant to section 1104(a) of the Bankruptcy Code or the appointment of an examiner pursuant to section 1104(b) of the Bankruptcy Code.

10. The May Notice of Charges represents a premature action by the Board, that is not even the primary regulator of the five remaining MBanks. In my opinion the Board should have given the Comptroller the opportunity to receive and review the capital raising plans of the three MBanks whose capital allegedly is below the minimum capital ratio requirements of the Comptroller. It would be an unnecessary, wasteful and burdensome obligation that would deplete the financial and other resources of MCorp and the other Debtors, without serving any useful purpose whatsoever, to require MCorp to respond to and litigate the May Notice of Charges prior to (a) consideration by the Comptroller of the capital plans that are to be submitted by three of the remaining MBanks, (b) prior to MCorp having had a reasonable opportunity to seek the concurrence of the Official Creditors' Committee to make capital contributions to the three remaining MBanks and (c) approval of the Bankruptcy Court of such action pursuant to section 363(b) of the Bankruptcy Code.

Respectfully submitted,

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By: /s/ Alan B. Miller
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Dated: Houston, Texas
June 2, 1989

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, ET AL., PLAINTIFFS, and
OFFICIAL CREDITORS' COMMITTE OF MCORP,
MCORP FINANCIAL, INC., and
MCORP MANAGEMENT, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 2, 1991]

ORDER

Since the modified preliminary injunction resolves all issues pending the decision of the United States Supreme Court, this case is closed except for enforcement on a motion of a party or modification on remand.

Signed on December *27th*, 1990, at Houston, Texas.

/s/ Lynn N. Hughes
LYNN N. HUGHES
United States District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

Civil Action No. H-89-1677

MCORP, ET AL., PLAINTIFFS, and
OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL, INC., and
MCORP MANAGEMENT, INTERVENOR

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM OF THE UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 2, 1991]

INJUNCTION ON REMAND

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1. *Parties.*

A. The parties plaintiff are:

(1) MCorp, a bank holding company;

(2) MCorp Financial, Inc., a non-bank subsidiary of MCorp; and

(3) MCorp Management, a non-bank subsidiary of MCorp.

(4) All the plaintiffs are debtors in possession.

B. The Official Creditors' Committee of MCorp, MCorp Financial, Inc., and MCorp Management under § 1102 of the Bankruptcy Code is an intervening party plaintiff.

C. The party defendant is the Board of Governors of the Federal Reserve System of the United States of America.

2. *Related Proceedings.* This civil action is an adversary proceeding in the consolidated chapter 11 cases of the debtors, and the reference of it by the district court to the bankruptcy court was withdrawn. Adversary Proceeding 89-0298. The other actions are:

A. An involuntary petition was filed in the Southern District of New York against MCorp, and it was transferred here to pend under Case 89-02324-H5-11.

B. A voluntary petition was filed in the Southern District of Texas by MCorp Management under Case 89-02324-H5-11.

C. A voluntary petition was filed in the Southern District of Texas by MCorp Financial, Inc., under Case 89-02312-H3-11.

D. The three bankruptcy actions have been consolidated under 89-02312-H3-11 for joint administration.

3. *Prior Proceedings.*

A. On June 2, 1989, the court preliminarily enjoined the Board from prosecuting certain administrative proceedings. The court issued a preliminary injunction on June 3, 1989, and amended it on June 19, 1989.

B. On August 23, 1990, the United States Court of Appeals for the Fifth Circuit issued the mandate reversing and vacating a portion of the prelimi-

nary injunction and remanding the case with instructions to enjoin the Board from prosecution of certain charges.

C. In accordance with the mandate, the preliminary injunction is modified and restated.

4. *Restraint.* The court decrees that:

The Board is enjoined from prosecuting an administrative proceeding against the debtors:

A. For an order to compel the debtors to

(1) Transfer property to their present or former subsidiary banks (or successors in interest to, or assignee of, those banks) or

(2) Take or refrain from taking any action in respect to the debtors' properties; or

B. Enforce the Board's source of strength doctrine or

C. Regulate the day-to-day financial soundness of the subsidiary banks.

5. *Reasons.* The court grants the restraint because:

A. A significant threat of irreparable harm to the plaintiffs exists if the injunction is not granted.

(1) Forcing the holding company to transfer funds to the subsidiary banks results in a wasting of corporate assets and violates the company's duty to its shareholders.

(2) The transfer of funds also deprives MCorp of its own separate corporate status.

B. The extent of harm to the plaintiffs resulting from failure to grant this order outweighs the Board's interest in supervising bank holding companies.

(1) The order does not impair:

(a) The Board's authority to determine the legitimacy of the transactions between

the closed banks and the holding company; or

(b) The Board's authority to prosecute charges under section 23A.

(2) The Board's interest in supervising bank holding companies does not include forcing a transfer of funds to the bank subsidiaries. The Board's interests, therefore, are unaffected by this order.

(3) An important purpose of the Bank Holding Company Act is to separate banking from commercial enterprises. Allowing the Board to treat the holding company as an extension of its bank subsidiaries undermines that purpose.

C. The plaintiffs will likely succeed on the merits of the case.

(1) The Board's interpretation of "unsafe and unsound" banking practices is unreasonable and impermissible and thus the Board may not require the transfer of holding company funds to the bank subsidiaries.

(2) MCorp is not required to exhaust its administrative remedies before seeking judicial relief because MCorp challenges the Board's legal authority to enforce the source of strength doctrine as a means to prevent unsafe and unsound banking practices.

(a) No facts are in dispute that require MCorp to exhaust its administrative remedies in the Board's proceedings.

(b) Congress has specified unsound transactions between bank holding companies and their bank subsidiaries, and it has never

mentioned the failure to inject capital into a bank subsidiary as an unsafe and unsound practice.

(3) A plain reading of 12 U.S.C. § 1818(i) indicates that the district court has jurisdiction to enjoin the Board if the Board exceeds it statutory authority.

D. The public interest is served by granting this injunction.

An effective and efficient bankruptcy reorganization, free from undue administrative interference, will proceed.

6. *Signing.*

Signed on December 27, 1990, at Houston, Texas.

/s/ Lynn N. Hughes
LYNN N. HUGHES
United States District Judge

SUPREME COURT OF THE UNITED STATES

No. 90-913

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

ORDER ALLOWING CERTIORARI

Filed March 4, 1991

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. This case is consolidated with 90-914, *MCorp, et al. v. Board of Governors of the Federal Reserve System of the United States* and a total of one hour is allotted for oral argument.

March 4, 1991

SUPREME COURT OF THE UNITED STATES

No. 90-914

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES

ORDER ALLOWING CERTIORARI

Filed March 4, 1991

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. This case is consolidated with 90-913, *Board of Governors of the Federal Reserve System of the United States v. MCorp Financial, Inc., et al.* and a total of one hour is allotted for oral argument.

March 4, 1991

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Nos. 90-913 and 90-914

In the Supreme Court of the United States

OCTOBER TERM, 1990

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

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QUESTIONS PRESENTED

1. Whether 12 U.S.C. 1818(i)(1) barred the district court presiding over MCorp's bankruptcy case from enjoining the Federal Reserve Board's pending administrative proceedings against MCorp under the Financial Institutions Supervisory Act of 1966, 12 U.S.C. 1818 *et seq.*

2. Whether despite the express limitation of 12 U.S.C. 1818(i)(1), the district court may invoke *Leedom* v. *Kyne,* 358 U.S. 184 (1958), to exercise jurisdiction over MCorp's claim that the Federal Reserve Board lacked statutory authority to file administrative charges enforcing its "source of strength" regulations.

3. Whether the Federal Reserve Board has statutory authority to promulgate and enforce its "source of strength" regulations, which make bank holding companies responsible for maintaining adequate capitalization of subsidiary banks.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, MCorp and MCorp Management were plaintiffs in the district court and appellees in the court of appeals. The Official Creditors' Committee of MCorp, MCorp Financial, Inc., and MCorp Management was an intervenor in the district court and an appellee in the court of appeals.

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In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-913

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL, INC., ET AL.

No. 90-914

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

OPINIONS BELOW

The opinion of the court of appeals (J.A. 13-36) is reported at 900 F.2d 852. The opinion of the district court (J.A. 37-55) is reported at 101 Bankr. 483.

JURISDICTION

The judgment of the court of appeals was entered on May 15, 1990. A petition for rehearing was denied on August 6, 1990. 90-913 Pet. App. 27a-28a. On October 22 and 26, 1990, Justice Scalia extended the time within which to file petitions for a writ of certiorari to and including December 10, 1990. The petitions were filed on that date, and were granted on March 4, 1991. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Pertinent sections of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(a), 1842(c), 1844) are reprinted at App., *infra,* 1a-8a. Pertinent sections of the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818), as amended by Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 103 Stat. 450-453, are reprinted at App., *infra,* 9a-26a. Sections 908 and 910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3907, 3909) are reprinted at App., *infra,* 26a-29a. Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, is reprinted at App., *infra,* 29a-38a. Pertinent sections of Federal Reserve Board regulations, 12 C.F.R. Part 225, are reprinted at App., *infra,* 38a-41a. Pertinent sections of the Bankruptcy Code (11 U.S.C. 105, 362; 28 U.S.C. 1334(b), 1334(d)) are reprinted at App., *infra,* 41a-50a.

STATEMENT

A. Federal Reserve Board Regulation of Bank Holding Companies

1. Congress has vested the Board of Governors of the Federal Reserve Board with substantial supervisory authority over the formation, structure, and operation of bank holding companies, *i.e.,* any company that has direct or indirect control of any bank. 12 U.S.C. 1841 (a)(1). The Board exercises such authority under three related statutory schemes—the Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. 1841 *et seq.,* the International Lending Supervision Act of 1983 (ILSA), 12 U.S.C. 3901 *et seq.,* and the Financial Institutions Supervisory Act (FISA), 12 U.S.C. 1818, as amended by Section 902 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, Tit. IX, 103 Stat. 450-453.

a. Under the BHCA, a company may not acquire a bank without first obtaining the Board's approval. 12 U.S.C. 1842(a). In reviewing a company's application to acquire a bank, the Board must consider, among other factors, "the financial and managerial resources and future prospects of the company or companies and the banks concerned." 12 U.S.C. 1842(c); see *Board of Governors* v. *First Lincolnwood Corp.,* 439 U.S. 234 (1978). The BHCA generally requires the company to limit its operations to banking activities and to other "nonbanking" activities that are closely related or a proper incident to banking. 12 U.S.C. 1843; see also 12 C.F.R. 225.21-225.31.[1] Under its supervisory powers, the Board "from time to time may require reports [from] * * * and * * * may make examinations of each bank holding company and each subsidiary thereof." 12 U.S.C. 1844(c). The Board has authority to curtail a bank holding company's "nonbank" activities that pose risks to a bank's financial stability or are "inconsistent with sound banking principles or with the purposes of [the BHCA]." 12 U.S.C. 1844(e).

b. Under Sections 908 and 910 of ILSA, 12 U.S.C. 3907 and 3909, the Board regulates and enforces the capital adequacy of each holding company. These provisions

[1] The BHCA empowers the Board to "issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of [the Act] and prevent evasions thereof." 12 U.S.C. 1844(b).

empower the Board to establish minimum capital levels, 12 U.S.C. 3907(a), and provide that the failure of a holding company to maintain these capital levels "may be deemed by the [Board], in its discretion, to constitute an unsafe and unsound practice within the meaning of [12 U.S.C. 1818]." 12 U.S.C. 3907(b)(1); see 12 U.S.C. 3909(a)(2). Moreover, ILSA provides that the Board may order holding companies to achieve required levels of capital where necessary to remedy unsafe or unsound banking practices. 12 U.S.C. 3907(b)(2); see 12 C.F.R. 263.35-263.40.

c. Under FISA, the Board has authority to begin "cease-and-desist" proceedings against a bank holding company if, in the Board's view, the company "is engaging or has engaged" or the Board "has reasonable cause to believe that [the company] is about to engage, in an unsafe or unsound practice in conducting the business of such [company]." 12 U.S.C. 1818(b)(1); see 12 U.S.C. 1818(b)(3) (Board's authority under Section 1818(b) applies to "any bank holding company, and to any subsidiary (other than a bank) of a bank holding company"). After an administrative hearing,[2] the Board may direct the holding company to "take affirmative action to correct the conditions resulting from any such violation or practice." 12 U.S.C. 1818(b)(1). As amended by Section 902 of FIRREA, FISA further provides that the Board's remedial powers include the authority to order the offending holding company, in certain circumstances,

[2] FISA and the Board's implementing regulations establish comprehensive procedures for exercising these enforcement powers. The statute requires sufficient notice to the holding company of the underlying charge, an evidentiary hearing before an independent presiding official, and a decision based on the hearing record. 12 U.S.C. 1818(b)(1), (b)(3), 1818(h). Board regulations further provide that the holding company may appear through counsel, compel the attendance of witnesses and the production of documents, adduce any relevant and material evidence, cross-examine adverse witnesses, and present its position through written submissions and oral arguments. 12 C.F.R. 263.1 *et seq.*

to make restitution to subsidiaries, to dispose of a loan or asset, or to "take such other action as [the Board] determines to be appropriate." 103 Stat. 450-451 (to be codified at 12 U.S.C. 1818(b)(6)).

In addition, the Board has authority under FISA to issue a temporary cease-and-desist order—without first holding a hearing—if it finds that the unsafe or unsound practice "is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors" before completion of administrative proceedings under Section 1818(b)(1). 12 U.S.C. 1818(c)(1). The Board's order under this provision may direct "affirmative action to prevent such insolvency, dissipation, condition, or prejudice pending completion of such proceedings." 12 U.S.C. 1818(c)(1). Such an order is effective immediately upon service and is enforceable by injunction in the appropriate United States District Court. 12 U.S.C. 1818(c)(1) and (d).

FISA provides specific avenues for judicial review of matters involving the Board's enforcement actions. First, a bank holding company may petition for review of a *final* cease-and-desist order under the Administrative Procedure Act, 5 U.S.C. 701 *et seq.*, in the appropriate United States Court of Appeals. 12 U.S.C. 1818(h)(2). Second, the United States District Courts have jurisdiction to issue an injunction "setting aside, limiting, or suspending" a *temporary* cease-and-desist order pending completion of the administrative enforcement proceedings. 12 U.S.C. 1818(c)(2). Third, upon the Board's application, the district courts have jurisdiction to enforce compliance with any notice or order issued under Section 1818. 12 U.S.C. 1818(i)(1). FISA, however, expressly bars federal courts from assuming jurisdiction to review or intervene in the Board's enforcement proceedings in any other manner or circumstances, stating that

> except as otherwise provided in [12 U.S.C. 1818] no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. 1818(i)(1); see 12 U.S.C. 1818(h)(1).

2. As part of its supervision of bank holding companies' corporate practices, the Board promulgated its "source of strength" regulation, which provides that "[a] bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not con[d]uct its operations in an unsafe or unsound manner." 12 C.F.R. 225.4(a)(1) (Regulation Y). The Board first articulated its "source of strength" concept as a policy in the case-by-case review of companies' applications to acquire banks. In reviewing these applications, the Board made clear that it would not approve bank acquisitions unless the prospective parent holding company would retain the ability to act as a source of financial and managerial assistance to its subsidiary banks, should the need for such assistance arise.[3] And in *First Lincolnwood Corp.*, 439 U.S. at 248, this Court upheld the Board's authority to disapprove the formation of a bank holding company on the basis of the grounds asserted in those administrative determinations, namely, the applicant's inability to act as a "source of strength" to subsidiary banks.

In 1984, the Board codified the source of strength policy in its published regulations governing a holding company's corporate practices. See 49 Fed. Reg. 818, 820 (1984). As part of that codification, the Board explained that its source of strength regulation

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[3] See, *e.g., Citizens Bancorporation*, 61 Fed. Res. Bull. 806, 806 (1975); *Midwest Bancorporation, Inc.*, 56 Fed. Res. Bull. 948, 950 (1970); *Mid-Continent Bancorporation*, 52 Fed. Res. Bull. 198, 200 (1966).

> is derived from section 3(c) of the BHC Act [12 U.S.C. 1842(c)], which requires the Board to consider the financial and managerial resources and future prospects of the company and banks concerned; from section 5(b) of the BHC Act [12 U.S.C. 1844(b)], which authorizes the Board to issue regulations; and from the Board's authority under the Financial Institutions Supervisory Act to issue cease and desist orders to prevent unsafe or unsound banking practices (12 U.S.C. 1818(b)(1) and (3)).

48 Fed. Reg. 23,520, 23,523 (1983) (notice of proposed rulemaking).

In 1987, the Board issued a formal statement clarifying its long-standing policy that bank holding companies should act as sources of strength to their subsidiary banks by "standing ready to use available resources to provide adequate capital funds to subsidiary banks during periods of financial stress or adversity." *Policy Statement; Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks*, 52 Fed. Reg. 15,707, 15,707 (1987). In support of that policy, the Board pointed out that a holding company derives financial benefits from ownership of institutions that can accept federally insured deposits, and reasoned that these commercial advantages create a correlative obligation to serve as sources of strength and support to subsidiary banks. *Ibid.* The Board also stated that bolstering a subsidiary bank's capital base promotes bank safety and public confidence, and reduces the federal deposit insurance fund's exposure to loss. *Ibid.* Accordingly, the Board stated that "[a] bank holding company's failure to assist a troubled or failing subsidiary bank * * * would generally be viewed as an unsafe and unsound banking practice or a violation of Regulation Y or both" that would result in an appropriate enforcement action. *Id.* at 15,707-15,708.

3. The Board also supervises bank holding companies' corporate practices under Section 23A of the Federal Reserve Act, 12 U.S.C. 371c. Section 23A, among other things, requires extensions of credit by a subsidiary bank to a nonbank affiliate to be secured by collateral. In particular, the statute prohibits a bank from extending credit to a nonbank affiliate unless, at the time of the transaction, the extension of credit is secured by collateral having a market value of at least 100% of the loan. Congress sought to "prevent misuse of commercial bank resources stemming from non-arm's length financial transactions with affiliated companies." S. Rep. No. 536, 97th Cong., 2d Sess. 31 (1982). Accordingly, Congress authorized the Board, in carrying out the statutory mandate, to

> issue such further regulations and orders, including definitions consistent with this section, as may be necessary to administer and carry out the purposes of this section and to prevent evasions thereof.

12 U.S.C. 371c(e).

B. Bankruptcy Court Jurisdiction and Equitable Authority

1. Congress has vested the United States District Courts with original and exclusive jurisdiction over all cases filed under the Bankruptcy Code. 28 U.S.C. 1334(a). The district court in which a bankruptcy case is filed also has exclusive jurisdiction over all the debtor's property as of the commencement of the case and the property of the debtor's bankruptcy estate. 28 U.S.C. 1334(d). Moreover, Congress has given the district courts concurrent jurisdiction over civil proceedings related to or arising out of a debtor's bankruptcy case:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

28 U.S.C. 1334(b).

2. Congress also gave the district courts certain equitable powers in connection with the exercise of bankruptcy jurisdiction. As relevant here, the Bankruptcy Code provides that the filing of a bankruptcy petition automatically stays

> the commencement or continuation * * * of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this [bankruptcy] title, or to recover a claim against the debtor that arose before the commencement of the case under this title.

11 U.S.C. 362(a)(1). The scope of this automatic stay, however, is limited. A bankruptcy petition does *not* operate as a stay

> under [11 U.S.C. 362(a)(1)], of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power.

11 U.S.C. 362(b)(4). Moreover, the Bankruptcy Code generally provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. 105.

C. The Proceedings in This Case

1. In October 1988, the Board issued a "notice of charges" under 12 U.S.C. 1818(b) against MCorp, a bank holding company headquartered in Texas. (MCorp and two of its subsidiaries involved in this case, MCorp Financial, Inc., and MCorp Management, will be referred to collectively as MCorp). MCorp then owned 25 subsidiary banks, many of which were in deteriorating financial condition and could not meet the Comptroller of the Currency's requirements for minimally acceptable capital reserves. The Board alleged that MCorp

> was engaging in unsafe and unsound practices, likely to cause substantial dissipation of the assets of

> MCorp that could be used to allow MCorp to serve as a source of financial strength for the subsidiary Banks.

J.A. 14; see *id.* at 39.[4] Accordingly, the Board scheduled an administrative hearing to determine whether the company should be ordered to cease and desist from specified unsafe and unsound practices and to undertake appropriate remedial measures. In an amended notice of charges filed a week later, the Board sought to require MCorp to

> implement[] an acceptable capital plan that would ensure that all of MCorp's available assets are used to recapitalize the Subsidiary Banks that are suffering capital deficiencies.

Id. at 14.

At the same time, the Board issued temporary cease-and-desist orders under 12 U.S.C. 1818(c)(1) that prohibited MCorp from dissipating its assets through dividend payments or unusual business transactions, and directed MCorp to identify those subsidiary banks that would receive capital infusions from MCorp's corporate assets and resources. See J.A. 65-67, 68-70, 84-86.

The Board postponed resolution of the "source of strength" charges pending MCorp's attempt to secure

[4] In particular, the Board alleged that it had reasonable cause to believe that

> MCorp will not take the actions that are necessary (1) to prevent the substantial dissipation of corporate assets through cash dividends, and (2) to maintain and prevent the dissipation of available resources at the parent company level that could be used, where appropriate, to make immediate capital injections into the Subsidiary Banks.

J.A. 63.

In the amended notice of charges filed one week later, the Board also alleged that it had reasonable cause to believe that "MCorp will not take the actions that are necessary * * * to use all available resources to make immediate capital injections into the Subsidiary Banks." J.A. 80-81.

"open bank" financial assistance from the Federal Deposit Insurance Corporation. See 12 U.S.C. 1823(c). In late March 1989, however, the FDIC denied MCorp's request, concluding that such financial assistance would not be in the public interest.

2. Soon after the FDIC's decision, three of MCorp's creditors filed an involuntary petition against MCorp in the United States Bankruptcy Court for the Southern District of New York. On March 28 and 29, 1989, the Comptroller of the Currency declared a total of 20 of MCorp's 25 subsidiary banks insolvent and, by operation of law, placed them under the receivership of the FDIC.[5] On March 31, MCorp filed voluntary bankruptcy petitions in the United States Bankruptcy Court for the Southern District of Texas. J.A. 14, 39.[6]

At this time, the Board issued a second notice of charges against MCorp. This notice alleged that MCorp had violated Section 23A of the Federal Reserve Act, 12 U.S.C. 371c. In particular, the notice claimed that MCorp had caused two of its closed banks to lend $63.7 million to MCorp Management without requiring sufficient collateral. J.A. 87-93; see *id.* at 14-15. And in late May 1989, the Board issued a second amended notice of charges (relating to the original October 1988 notice), alleging that MCorp had failed to act as a "source of strength" to its five remaining subsidiary banks. *Id.* at 186-195.[7]

[5] MCorp later filed a separate federal court action against the Comptroller of the Currency and the FDIC, alleging that the closing of 12 of its subsidiary banks violated the National Bank Act. On February 1, 1991, the district court entered an order granting MCorp's motion for partial summary judgment. *MCorp* v. *Clarke*, No. CA3-89-0831-F (N.D. Tex. Feb. 1, 1991). That case remains pending before the district court.

[6] The voluntary and involuntary bankruptcy proceedings were later consolidated in the Southern District of Texas. J.A. 14.

[7] Given the divestiture of MCorp's interest in the banks declared insolvent by the Comptroller, MCorp had no further obligation to act as a source of strength to those banks.

3. Before the Board held an administrative hearing on the outstanding charges, MCorp filed an adversary bankruptcy proceeding against the Board in the Southern District of Texas. MCorp sought a temporary restraining order and a preliminary injunction to prevent the Board from prosecuting its administrative charges and taking further actions against MCorp without prior approval of the bankruptcy court. J.A. 102-124, 125-140. On May 3, 1989, the bankruptcy court denied MCorp's request for temporary relief. *Id.* at 15.

The Board then filed in the district court for the Southern District of Texas a motion to withdraw the reference of the adversary proceeding in the bankruptcy court. See 28 U.S.C. 157(d). The district court granted that motion on May 12, thereby agreeing to exercise jurisdiction over MCorp's request for injunctive relief. J.A. 15.

On June 9, the district court granted MCorp's motion and issued a preliminary injunction against the Board's administrative enforcement proceedings. J.A. 37-55. The court concluded that the express jurisdictional limitation contained in FISA, 12 U.S.C. 1818(i)(1)—providing that "[n]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement" of any Board order, except as set forth in the statute—has "been overridden through control of the debtor's estate having been entrusted to the authority of the bankruptcy court." J.A. 44-45; see 28 U.S.C. 1334(d).[8]

[8] Alternatively, the court determined that "the Board's generalized, diffuse interest in the holding company as well as the duplicative, distracting hearings militate for its being not exempt from the [automatic stay provisions of the Bankruptcy Code, 11 U.S.C. 362]." J.A. 48. Moreover, the court held that it had general equitable power under 11 U.S.C. 105 to enjoin the Board's proceedings that would threaten MCorp's assets or otherwise impede MCorp's reorganization. J.A. 48-49.

D. The Court of Appeals Decision

In May 1990, the Fifth Circuit vacated the injunction barring further proceedings on the Board's Section 23A charges, but remanded with instructions to enjoin proceedings on the Board's source of strength charges. J.A. 13-36.

With respect to its jurisdiction, the court of appeals concluded that

> the plain language of § 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings if the Board's actions do not exceed the authority Congress granted to it.

J.A. 22. In so concluding, the court rejected MCorp's contention that the bankruptcy jurisdiction conferred by 28 U.S.C. 1334 supersedes or otherwise qualifies FISA's express limitation (12 U.S.C. 1818(i)) on a court's equitable jurisdiction. As the court explained, 28 U.S.C. 1334(b) (as well as its legislative history) "reflects no intent that the bankruptcy court's jurisdiction supersede the exclusive jurisdiction of an administrative agency, or reinvest the courts with jurisdiction barred by § 1818." J.A. 18. Section 1334(d) was inapplicable, the court determined, because "the Board has not sought control over the property of MCorp's estate in this action, only the opportunity to go forward in its administrative proceedings. J.A. 20.

Nevertheless, citing *Leedom* v. *Kyne*, 358 U.S. 184 (1958) and circuit precedent, the court of appeals determined that

> [i]f the Board's proceedings exceed its statutory authority, we may review the Board's action * * * despite the jurisdictional bar of § 1818; if the Board "was not acting within [the] authority granted by Congress, then 12 U.S.C. § 1818(i) could not withdraw jurisdiction."

J.A. 22-23 (quoting *Manges* v. *Camp*, 474 F.2d 97, 99 (5th Cir. 1973)). The court therefore concluded that

the district court's authority to enjoin the Board's administrative proceedings at issue depended on whether those proceedings fell within the Board's statutory mandate.

Turning first to the Board's Section 23A proceedings, the court of appeals determined that the Board had authority to regulate MCorp's relationship with former subsidiary banks and therefore held that the Board was "well within its authority in seeking an order against MCorp to cease and desist any transactions which violate the provisions of § 23A, or 'to take affirmative action' as may be appropriate." J.A. 24 (quoting 12 U.S.C. 1818(b)(1)).

Turning next to the Board's "source of strength" proceedings, the court of appeals held that those "proceedings exceed[ed] [the Board's] statutory authority." J.A. 13.[9] The court concluded that the BHCA "does not grant the Board authority to consider the financial and managerial soundness of the subsidiary banks after it approves the application." *Id.* at 31. Accordingly, the court held that "the Board is without authority under the BHCA to require [MCorp] to transfer its funds to its troubled subsidiary bank." *Ibid.*[10]

The court of appeals also rejected the Board's contention that "MCorp's failure to provide capital to its subsidiary banks [is] an unsafe or unsound practice which

[9] As a threshold matter, the court rejected the argument that MCorp may not challenge the Board's authority because it has not exhausted its administrative remedies. In the court's view, "[t]he sole question presented is a legal one * * * [and that] legal issue * * * can be resolved without further factual development." J.A. 25-26.

[10] The court suggested that the Board was not necessarily without an adequate alternative to its "source of strength" regulations. In its view, "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial [s]oundness." J.A. 31-32 n.5 (noting similar practice of the Office of Thrift Supervision).

the Board may act to restrain under [FISA, 12 U.S.C. 1818]." J.A. 32. Applying the framework established by *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), the court determined that "Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies." J.A. 33. The court therefore examined the "reasonableness" and permissibility" of the Board's construction of that phrase, *i.e.*, that a "failure of the holding company to inject capital into subsidiary banks is an 'unsafe or unsound' practice." *Ibid.*

In the court's view, "[e]nforcement of the Board's source of strength regulation * * * can hardly be considered a 'generally accepted standard[] of prudent operation.'" J.A. 34 (quoting 112 Cong. Rec. 26,474 (1966), cited in *Gulf Federal Savings & Loan Ass'n* v. *Federal Home Loan Bank Bd.*, 651 F.2d 259, 264 (5th Cir. 1981), cert. denied, 458 U.S. 1121 (1982)). Not only would such a transfer of funds require a holding company such as MCorp "to disregard its own corporation's separate status," it would also "amount to a wasting of the holding company's assets in violation of its duty to its shareholders." J.A. 34. Moreover, the court stated that the Board's regulations conflict with "one of the fundamental purposes of the BHCA," namely, "to separate banking from commercial enterprises," since those regulations would permit the Board to treat a holding company as "merely an extension of its subsidiary bank." *Ibid.*[11] Accordingly, the court concluded that

> the Board's determination that the holding company's failure to transfer its assets to a troubled subsidiary was an "unsafe or unsound practice" under §§ 1818

[11] In this regard, the court noted that Congress, in enacting and amending the BHCA in 1956 and 1966, "set forth detailed limits on transactions considered unsound between subsidiary banks and holding companies, without mentioning the infusion of capital by holding companies into subsidiaries." J.A. 35.

(b)(1) and (3) is an unreasonable and impermissible interpretation of that term.

J.A. 35.[12]

SUMMARY OF ARGUMENT

I. FISA's express limitations on federal court equitable jurisdiction protect a narrow class of administrative actions from premature judicial interference. Until the Board's proceedings culminate in a final cease-and-desist order, FISA bars the federal courts from exercising equitable jurisdiction over pending administrative actions. The statute could not be clearer: "[N]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order." 12 U.S.C. 1818(i)(1).

In this case, MCorp jumped the gun in seeking to stop the Board's enforcement proceedings in their tracks upon the filing of notices of charges. Accommodating MCorp's litigation strategy, the district court's injunction flies in the face of the plain language of FISA's preclusion pro-

[12] On August 6, 1990, the court of appeals denied the Board's petition for rehearing and suggestion of rehearing en banc. 90-913 Pet. App. 27a-28a. On August 23, the court of appeals denied MCorp's motion for a stay of the mandate.

On remand from the court of appeals, the district court in November 1990 entered an order enjoining the Board from, among other activities, prosecuting its outstanding source of strength administrative charges against MCorp. Injunction on Remand ¶ 4, *MCorp* v. *Board of Governors*, No. H-89-1677 (S.D. Tex. Nov. 8, 1990). In January 1991, the district court issued a modified injunction retaining that prohibition. J.S. 222; see *id.* at 219, 220-224.

MCorp, through the pending bankruptcy proceedings, has been pursuing plans to sell each of its remaining five subsidiary banks. To date, MCorp has sold two of those banks. See 90-913 Br. in Opp. 3. MCorp has also executed contracts to sell two of its three remaining banks. Those contracts have not yet received the requisite approvals from either the bankruptcy court or the appropriate federal banking regulators.

vision, 12 U.S.C. 1818(i). Accordingly, the court of appeals should have vacated the district court's order barring the Board from prosecuting its enforcement action.

Nothing in the Bankruptcy Code calls for a different outcome. In vesting federal courts with jurisdiction and equitable authority over bankruptcy matters, see 11 U.S.C. 105, 362; 28 U.S.C. 1334, Congress has not superseded FISA's preclusion provision. None of those bankruptcy provisions—by their terms—purport to repeal or qualify FISA's express and more particular limitations on federal court equitable jurisdiction. The Bankruptcy Code's "automatic stay" provision, 11 U.S.C. 362, does not carve out an exception to Section 1818(i). Similarly, the Code's general grant of equitable authority, 11 U.S.C. 105(a), does not supersede the precise jurisdictional limitations of FISA. And Congress's general grant of jurisdiction over bankruptcy matters in 28 U.S.C. 1334 does not take precedence over FISA's withdrawal of jurisdiction in 12 U.S.C. 1818(i).

II. Despite its otherwise correct and straightforward reading of Section 1818(i), the court of appeals proceeded to review the substantive validity of the Board's source of strength regulations under the doctrine set forth in *Leedom* v. *Kyne*, 358 U.S. 184 (1958). That review, under the circumstances presented here, amounts to a misappropriation of jurisdiction under *Leedom* v. *Kyne* in violation of Congress's intent.

Jurisdiction under *Leedom* v. *Kyne* is inappropriate where, as here, Congress has provided alternative means of judicial review of agency action. See 12 U.S.C. 1818(h)(2), 1818(i)(1). Indeed, jurisdiction under *Leedom* is reserved for the extreme circumstance of reviewing agency action that is manifestly beyond the agency's delegated authority and thus in excess of the agency's jurisdiction. The decision below improperly brushed aside this fundamental limitation; the error in so doing is all the more manifest by the court of appeals' concession that the Board's authority to promulgate and

enforce its source of strength regulations turned on application of the second prong of the *Chevron* framework. That only applies when the answer is *not* plain from the statute. In addition, *Leedom* does not apply in the circumstances presented, *i.e.*, the absence of legally binding agency action. Here, the Board has only filed notices of charges and initiated administrative proceedings. At bottom, the court of appeals—in the face of the express preclusion provision of FISA—had no occasion even to review the Board's source of strength regulations under the guise of *Leedom*-based jurisdiction.

III. Even assuming the court of appeals had jurisdiction to consider the validity of the Board's source of strength regulations, the court erred in striking them down. In doing so, the court of appeals misconstrued the Federal Reserve Board's statutory authority, derived from three statutes (the Financial Institutions Supervisory Act, the International Lending Supervision Act, and the Bank Holding Company Act, see pp. 2-6, *supra*) to supervise bank holding companies' activities regarding subsidiary banks—particularly where those activities may adversely affect bank safety. The decision below is inconsistent with Congress's delegation of supervisory power to the Board and impermissibly restricts the Board's delegated authority to exercise continuing control and supervision of bank holding company practices that impair the stability of the Nation's banking system.

ARGUMENT

I. FEDERAL COURTS SITTING IN BANKRUPTCY LACK AUTHORITY TO ENJOIN PENDING FEDERAL RESERVE BOARD ENFORCEMENT ACTIONS AGAINST BANK HOLDING COMPANIES UNDER THE FINANCIAL INSTITUTIONS SUPERVISORY ACT

A. The Financial Institutions Supervisory Act Provides The Exclusive Means For Judicial Review Of Federal Reserve Board Enforcement Actions Against Bank Holding Companies

Under FISA, 12 U.S.C. 1818, as amended by Section 902 of FIRREA, Pub. L. No. 101-73, Tit. IX, 103 Stat. 450-453, the Federal Reserve Board exercises broad and exclusive authority to regulate bank holding companies. Congress sought through this legislation to fill the regulatory gap concerning actions of a parent holding company or one of its "nonbank" subsidiaries that threatened the safety, soundness, or stability of a subsidiary bank. See S. Rep. No. 902, 93d Cong., 2d Sess. 10 (1974).[13] As a result, Congress amended FISA in 1974 to grant the Board exclusive power—after administrative proceedings—to compel a holding company to cease and desist from unsafe and unsound banking practices. See Act of Oct. 28, 1974, Pub. L. No. 93-495, Tit. I, § 110, 88 Stat. 1506 (codified at 12 U.S.C. 1818(b)(3)); see also pp. 37-42, *infra*.

FISA's express provisions for judicial review of matters involving the Board's enforcement actions confirm Congress's firm commitment to the Board's expertise in regulating bank holding company practices. First, a bank holding company may petition for review of a *final* cease-

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[13] As originally enacted in 1966, FISA's authority to remedy unsafe banking practices applied principally to federally insured banks and did not extend to bank holding companies. See Act of Oct. 16, 1966, Pub. L. No. 89-695, § 201, 80 Stat. 1046.

and-desist order under the Administrative Procedure Act, 5 U.S.C. 701 *et seq.*, in the appropriate United States Court of Appeals. 12 U.S.C. 1818(h)(2).[14] Second, the United States District Courts have jurisdiction to issue an injunction "setting aside, limiting, or suspending" a *temporary* cease-and-desist order pending completion of the administrative enforcement proceedings. 12 U.S.C. 1818(c)(2). Third, *upon the Board's application*, the district courts have jurisdiction to enforce compliance with any notice or order issued under Section 1818. 12 U.S.C. 1818(i)(1). FISA, however, expressly bars federal courts from assuming jurisdiction to review or intervene in the Board's enforcement proceedings in any other manner or circumstances. Its language of preclusion is admirably clear:

> [E]xcept as otherwise provided in [12 U.S.C. 1818] no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. 1818(i)(1); see 12 U.S.C. 1818(h)(1).

Under this straightforward statutory scheme, Congress has shielded the Board's ongoing enforcement actions from premature judicial interference. Until the Board's proceedings culminate in a final cease-and-desist order, FISA's plain language bars the federal courts from exercising equitable jurisdiction over pending administrative actions. For that reason, the lower courts have unanimously agreed that Section 1818(i) divests courts of

[14] Once a petition for review is filed, FISA provides that the court of appeals' jurisdiction shall be "exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency." 12 U.S.C. 1818(h)(2). The sole exception to this exclusive jurisdiction is limited to instances where the Board, with the court's permission, modifies, terminates, or sets aside its order. See 12 U.S.C. 1818(h)(1) and (2).

equitable jurisdiction to enjoin pending enforcement proceedings initiated under FISA's authority to order a financial institution to "cease and desist" from unsafe or unsound banking practices or violations of law. See *Eastern Nat'l Bank* v. *Conover*, 786 F.2d 192, 193 (3d Cir. 1986); *Investment Co. Inst.* v. *FDIC*, 728 F.2d 518, 524-525 (D.C. Cir. 1984); *First Nat'l Bank* v. *United States*, 530 F. Supp. 162, 166-168 (D.D.C. 1982); see also *Groos Nat'l Bank* v. *Comptroller of Currency*, 573 F.2d 899, 895 (5th Cir. 1978) (FISA precludes exercise of equitable jurisdiction absent the agency's clear departure from statutory authority).

Here, MCorp jumped the gun in seeking to stop the Board's enforcement proceedings when the Board filed notices of charges. And the district court's injunction against those proceedings is flatly inconsistent with the plain language of 12 U.S.C. 1818(i). Accordingly, the court of appeals should have vacated the district court's order barring further prosecution of the Board's enforcement action in its entirety. See *Business Guides, Inc.* v. *Chromatic Communications Enters., Inc.*, 111 S. Ct. 922, 928 (1991) ("[O]ur inquiry is complete if we find the text * * * to be clear and unambiguous."); *Pavelic & LeFlore* v. *Marvel Entertainment Group*, 110 S. Ct. 456, 460 (1989) ("Our task is to apply the text, not to improve upon it."); *Hallstrom* v. *Tillamook County*, 110 S. Ct. 304, 309 (1989) (courts "are not at liberty to create an exception where Congress has declined to do so").

B. The Bankruptcy Code Does Not Supersede FISA's Preclusion Of Judicial Review Or Otherwise Authorize Equitable Jurisdiction Over Pending Federal Reserve Board Enforcement Actions

In vesting federal courts with jurisdiction and equitable authority over bankruptcy matters, see 11 U.S.C. 105, 362; 28 U.S.C. 1334, Congress has not superseded FISA's preclusion provision, 12 U.S.C. 1818(i). As an

initial matter, none of those bankruptcy provisions—by their terms—purport to repeal or qualify FISA's express limitations on federal court equitable jurisdiction. As this Court has long recognized, "[w]here there is no *clear* intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment." *Crawford Fitting Co.* v. *J.T. Gibbons, Inc.*, 482 U.S. 437, 445 (1987) (internal quotation marks and citations omitted). That canon of statutory construction applies with particular force where, as here, Congress has expressly limited federal court jurisdiction over a particular subject matter: " 'When there are statutes clearly defining the jurisdiction of the courts the force and effect of such provisions should not be disturbed by mere implication flowing from subsequent legislation.' " *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 808 (1976) (quoting *Rosencrans* v. *United States*, 165 U.S. 257, 262 (1897)).

In this case, Congress enacted a specific jurisdictional limitation in FISA protecting a narrow class of administrative actions from premature judicial interference. In the absence of congressional intent reflected in either the text or legislative record of the various bankruptcy provisions MCorp invokes, see 90-914 Pet. 10-25, the court of appeals correctly declined MCorp's invitation to ascribe to Congress an intention to except bankruptcy proceedings from the straightforward application of FISA's withdrawal of jurisdiction.[15]

[15] Where Congress intended the bankruptcy courts to exercise equitable jurisdiction previously withheld by statute, it said so. For example, in enacting 11 U.S.C. 105, which grants the bankruptcy court the power to issue orders necessary to carry out the purposes of the Bankruptcy Code, Congress noted its intent to carve out an exception to the anti-injunction provisions of 28 U.S.C. 2283, and to authorize injunctions staying actions in state court. H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 (1977); see also 28 U.S.C. 1334(b) (conferring concurrent bankruptcy jurisdiction over civil proceedings otherwise committed to the exclusive jurisdiction of another court). MCorp can point to no similar expressions of Congress's intent to repeal FISA's anti-injunction provisions, let alone evidence of the "clear intention" that is required. *Crawford Fitting*, 482 U.S. at 445.

1. The Bankruptcy Code's "automatic stay" provision, 11 U.S.C. 362, does not carve out an exception to Section 1818(i). Section 362 generally provides that the filing of a petition in bankruptcy "operates as a stay, applicable to all entities, of—(1) the commencement or continuation * * * of a judicial, administrative, or other action or proceeding against the debtor * * * or to recover a claim against the debtor that arose before the commencement of the [bankruptcy] case." 11 U.S.C. 362(a)(1). Although Section 362 confers certain equitable powers once the court sitting in bankruptcy acquires jurisdiction, the provision does not purport to define or confer jurisdiction. By its terms, FISA makes clear that no court has authority "to affect by injunction or otherwise" the Board's pending administrative proceedings. 12 U.S.C. 1818(i)(1). For that reason alone, Section 362 cannot otherwise trump the withholding of injunctive power in FISA.

In any event, Section 362 could not support an injunction or stay of the Board's administrative proceedings in this case. The Bankruptcy Code provides that the stay imposed by 11 U.S.C. 362(a) does not extend to "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power." 11 U.S.C. 362(b)(4). The Board's proceedings commenced under FISA fall comfortably within this so-called "police or regulatory power" exception. Courts have long recognized that the government's "police power" "embraces regulations designed to promote the public convenience or the general prosperity, as well as regulations designed to promote the public health, the public morals or the public safety." *Chicago, B. & Q. Ry.* v. *Illinois ex rel. Drainage Commissioners*, 200 U.S. 561, 592 (1906). And given the

plain meaning of the term "regulatory,"[16] the courts of appeals have consistently held that the "police or regulatory power" exception to the stay extends to the broad range of regulatory activities, including economic regulation of business practices similar to the banking regulations at issue in this case.[17]

2. The Bankruptcy Code's general grant of equitable authority, 11 U.S.C. 105(a), likewise does not supersede the jurisdictional limitations of FISA. Section 105(a) provides that a court exercising bankruptcy jurisdiction

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[16] See, *e.g.*, *Webster's Third New International Dictionary* 1913 (1986) (defining "regulate" as "to govern or direct according to rule"); *FPC* v. *Corporation Comm'n*, 362 F. Supp. 522, 532 (W.D. Okla. 1973) ("The primary meaning of the word 'regulate' is to lay down the rule by which a thing shall be done."); see 5 U.S.C. 551(4) (defining "rule," for purposes of the Administrative Procedure Act, as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy * * * and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof").

[17] See, *e.g.*, *Eddleman* v. *Department of Labor*, 923 F.2d 782, 790-791 (10th Cir. 1991) (Department of Labor action to enforce minimum wage standards of Service Contract Act exempt from automatic stay); *In re Commonwealth Cos.*, 913 F.2d 518, 521-526 (8th Cir. 1990) (government's action under the False Claims Act exempt from automatic stay); *Brock* v. *Rusco Indus., Inc.*, 842 F.2d 270, 273 (11th Cir.) (action under Fair Labor Standards Act to recover unpaid minimum wages exempt from automatic stay), cert. denied, 488 U.S. 889 (1988); *In re Berry Estates, Inc.*, 812 F.2d 67, 71 (2d Cir.) (rent control proceedings exempt from automatic stay), cert. denied, 484 U.S. 819 (1987); *NLRB* v. *Edward Cooper Painting, Inc.*, 804 F.2d 934, 942 (6th Cir. 1986) (NLRB unfair labor practice proceedings exempt from automatic stay); *Cournoyer* v. *Town of Lincoln*, 790 F.2d 971, 974-977 (1st Cir. 1986) (action to enforce zoning restrictions exempt from automatic stay); *CFTC* v. *Co Petro Marketing Group, Inc.*, 700 F.2d 1279, 1283-1284 (9th Cir. 1983) (CFTC action to enjoin violations of Commodity Exchange Act exempt from automatic stay); *SEC* v. *First Financial Group*, 645 F.2d 429, 437 (5th Cir. 1981) (SEC proceeding to enjoin fraudulent sales of securities exempt from automatic stay).

"may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code." That provision, however, is not a roving commission to do equity or a license to advance the interests of the debtor without regard to other substantive limitations on the debtor's conduct or the bankruptcy courts' powers. As this Court has recognized, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988). Indeed, the Court recently pointed out that "a bankruptcy court order [issued under Section 105] might be inappropriate if it conflicted with another law that should have been taken into consideration in the exercise of the court's discretion." *United States* v. *Energy Resources Co.*, 110 S. Ct. 2139, 2142 (1990). In other words, Section 105—as a grant of general equitable power—does not purport to redefine bankruptcy court jurisdiction or otherwise repeal express limitations on the court's equitable powers.

MCorp nevertheless asserts that FISA's jurisdictional limitation must give way where its application would conflict with the "policies and goals of the Bankruptcy Code, or the efficient administration of a bankruptcy case." 90-914 Pet. 15. But such ill-defined considerations do not supersede the sort of express legislative determination reflected in FISA, 12 U.S.C. 1818(i). As this Court has pointed out:

> If Congress wishes to grant the [bankruptcy] trustee an extraordinary exemption from nonbankruptcy law, "the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt."

Midlantic Nat'l Bank v. *New Jersey Dep't of Envt'l Protection*, 474 U.S. 494, 501 (1986) (quoting *Swarts* v. *Hammer*, 194 U.S. 441, 444 (1904)); cf. *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 110 S. Ct. 2126,

2132 n.4 (1990) (construction of Bankruptcy Code must be based on language of statute, as opposed to policy "unsupported by any textual authority"). MCorp can point to nothing in the text of 11 U.S.C. 105 that empowers the bankruptcy court to ignore independent and express limitations on its equitable jurisdiction, such as that found in FISA, 12 U.S.C. 1818(i).

3. MCorp also errs in suggesting (90-914 Pet. 17-25) that Congress's general grant of jurisdiction over bankruptcy matters in 28 U.S.C. 1334 takes precedence over FISA's precise withdrawal of jurisdiction in 12 U.S.C. 1818(i). MCorp, for example, first mistakenly relies on 28 U.S.C. 1334(b), which provides:

> Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

By providing that the district courts may exercise this jurisdiction "[n]*otwithstanding* any Act of Congress that confers exclusive jurisdiction on a *court or courts* other than the district courts" (emphasis added), Congress effectively superseded jurisdictional limitations that otherwise would have deprived the district courts of jurisdiction over matters previously committed to the exclusive jurisdiction of another *judicial* forum. See *Brock* v. *Morysville Body Works, Inc.*, 829 F.2d 383, 385-387 (3d Cir. 1987). The statute, however, does not speak to ongoing proceedings before an administrative agency. Rather, Congress referred only to civil proceedings that would lie within another court's jurisdiction. For that reason, the court of appeals correctly concluded that Congress limited the reach of Section 1334(b) to the "division of jurisdiction between bankruptcy courts and *other courts*." J.A. 18.

MCorp similarly errs (90-914 Pet. 21) in asserting that 28 U.S.C. 1334(d) vests the bankruptcy courts with

exclusive jurisdiction over FISA proceedings.[18] Section 1334(d) gives the court *in rem* jurisdiction to resolve issues affecting title to or control of the debtor's property, see, *e.g.*, *In re Modern Boats, Inc.*, 775 F.2d 619 (5th Cir. 1985), as opposed to exclusive jurisdiction over any matter that happens to touch upon the debtor's estate. As this Court has pointed out in construing a substantially similar predecessor to Section 1334(d):

> [A] court of bankruptcy has exclusive and nondelegable control over the administration of an estate in its possession. * * * There can be no question, however, that Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate.

Callaway v. *Benton*, 336 U.S. 132, 142 (1949) (citations omitted).[19]

Here, as the court of appeals recognized, "the Board has not sought control over the property of MCorp's estate in this action, only the opportunity to go forward in

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[18] Section 1334(d) provides:

> The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.

[19] The bankruptcy courts' exclusive jurisdiction over the debtor's property can be traced back as far as the Bankruptcy Act of 1898. As one commentator has explained:

> The jurisdiction of the bankruptcy court under the [1898] Act was *in rem*, and turned (absent consent of an adverse party) upon custody or possession of the court. If the property of the bankrupt were in the possession of the court * * * the bankruptcy court had the jurisdiction to determine rights and interests of contending parties in and to that property. Without possession, jurisdiction was absent.

1 *Collier Bankruptcy Manual* ¶ 3.01, at 3-11 (3d ed. 1990); see, *e.g.*, *Cline* v. *Kaplan*, 323 U.S. 97, 98-99 (1944); *Thompson* v. *Magnolia Co.*, 309 U.S. 478, 481-482 (1940); *Murphy* v. *John Hofman Co.*, 211 U.S. 562, 568-570 (1909).

its administrative proceedings." J.A. 20. The Board's administrative proceedings seek to ascertain whether MCorp has violated the law or committed unsafe or unsound banking practices. Those proceedings, like all regulatory measures, may ultimately proscribe or compel certain conduct and in that indirect sense may "affect" MCorp's property. But such tangential effects—aside from being entirely speculative at this juncture—would not otherwise bring the Board's administrative actions within the bankruptcy court's exclusive jurisdiction over MCorp's property.

4. At bottom, MCorp may not avoid the unambiguous jurisdictional limitations imposed by FISA, 12 U.S.C. 1818(i), by extolling the rehabilitative functions, policies, and goals of the Bankruptcy Code. Those attributes of the Code, however laudable, cannot confer jurisdiction where none exists. Cf. *Grogan* v. *Garner,* 111 S. Ct. 654, 659 (1991) (general policies of Bankruptcy Code do not override specific nondischargeability provision). As the courts have routinely recognized, if the bankruptcy court lacks authority to interfere with an administrative enforcement proceeding or other action against the debtor, the fact that the matter might adversely affect the debtor's reorganization is irrelevant.[20]

This Court has made clear that

> [t]he courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.

[20] See, *e.g., In re Heritage Village Church & Missionary Fellowship, Inc.,* 851 F.2d 104, 105-106 (4th Cir. 1988); *United States* v. *Huckabee Auto Co.,* 783 F.2d 1546, 1549 (11th Cir. 1986); *Briggs Transp. Co.* v. *International Bhd. of Teamsters,* 739 F.2d 341, 343-344 (8th Cir.), cert. denied, 469 U.S. 917 (1984); *In re Crowe & Assocs., Inc.,* 713 F.2d 211, 214-216 (6th Cir. 1983); *In re Petrusch,* 14 Bankr. 825, 829 (N.D.N.Y. 1981), aff'd per curiam, 667 F.2d 297 (2d Cir.), cert. denied, 456 U.S. 974 (1982).

Morton v. *Mancari,* 417 U.S. 535, 551 (1974). Congress, through FISA, 12 U.S.C. 1818(i), and the "police or regulatory power" exception to the automatic stay provision, 11 U.S.C. 362(b)(4), has balanced the debtor's need for protection from actions that could impede reorganization against the government's need to enforce the law. And Congress has struck the balance in favor of enabling the government to enforce its police and regulatory powers—a state of affairs that is consistent with FISA's provisions shielding the Board's administrative proceedings from premature judicial interference. Accordingly, the court of appeals correctly concluded that "§ 1818(i) deprives the district court of jurisdiction to enjoin the Board's administrative proceedings * * *," J.A. 22, and should have vacated the district court's order barring further prosecution of the Board's enforcement action in its entirety.

II. THE FEDERAL RESERVE BOARD'S SOURCE OF STRENGTH REGULATIONS ARE NOT SUBJECT TO JUDICIAL REVIEW UNDER THE DOCTRINE SET FORTH IN *LEEDOM* v. *KYNE,* 358 U.S. 184 (1958)

The court of appeals had no difficulty understanding what 12 U.S.C. 1818(i) said, but it went on to conclude that it did not mean what it said. Despite the court's otherwise correct and straightforward reading of the explicit preclusion provision of FISA, 12 U.S.C. 1818(i), the court of appeals proceeded to review the substantive validity of the Board's source of strength regulations under the doctrine enunciated in *Leedom* v. *Kyne,* 358 U.S. 184 (1958). As we explain below, the court of appeals invalidated the Board's regulations based on a flawed construction of the interrelated statutory schemes Congress established to empower the Board to supervise bank holding companies' activities regarding subsidiary banks. See pp. 36-45, *infra.* As a threshold matter, however, the court of appeals erred in misappropriating jurisdiction

to reach the merits under *Leedom*. Such an exercise of jurisdiction—in the face of FISA's preclusion provision —should not stand.

A. In The Face Of Statutory Judicial Review Provisions, Jurisdiction Under *Leedom* v. *Kyne* Is Limited To Exceptional Cases Of Unauthorized Agency Action

This Court has emphasized "the painstakingly delineated procedural boundaries of [*Leedom* v.] *Kyne*." Indeed, the Court has made plain that the "*Kyne* exception [to statutory judicial review provisions] is a narrow one." *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 481 (1964); see *Brotherhood of Ry. & S.S. Clerks* v. *Association for the Benefit of Non-Contract Employees*, 380 U.S. 650, 660 (1965). The limited reach of jurisdiction under *Leedom* v. *Kyne* is readily apparent in view of the circumstances presented in that case.

In *Leedom*, union representatives challenged a National Labor Relations Board order including both professional and nonprofessional employees within the same collective bargaining unit without the professional employees' consent. 358 U.S. at 186. This Court held that although bargaining unit certifications were not reviewable final orders under the National Labor Relations Act, the district court nonetheless had jurisdiction to consider the union's challenge. *Id.* at 191. The Court explained that lawsuit was

> not one to "review," in the sense of that term as used in the [National Labor Relations] Act, a decision of the Board made within its jurisdiction. Rather it is one to strike down an order of the Board made in excess of its delegated powers and contrary to a specific prohibition in the Act.

Id. at 188. The Court noted that it could not "lightly infer that Congress does not intend judicial protection of rights it confers against agency action taken in excess of delegated powers." *Id.* at 190. As a result, the Court

concluded that, despite the governing statute's failure to provide for judicial review, Congress intended that the statutory rights violated by the NLRB remain judicially enforceable through the general jurisdiction of the federal courts. *Id.* at 190-191.

B. The Board's Proceedings Under FISA To Enforce The Source Of Strength Regulations Do Not Fall Within The Limited Reach Of Jurisdiction Under *Leedom* v. *Kyne*

In this case, the Board has only *initiated* administrative proceedings under FISA to determine whether MCorp has engaged in impermissible banking practices regarding its supervision of subsidiary banks. On the record presented here, the court of appeals' invocation of *Leedom* v. *Kyne* to assume jurisdiction to review the validity of the Board's substantive source of strength policy—despite FISA's explicit preclusion provision—ignores in several critical respects this Court's limitations on the *Leedom* doctrine.

1. *Leedom* neither held nor suggested that federal courts could invoke their "general jurisdiction" to review agency action, particularly where, as here, the governing statute itself provides an exclusive avenue of review that affords a full and complete means of securing judicial vindication of statutory rights. *Leedom*'s jurisdictional holding was largely predicated on the fact that the aggrieved union had no other effective means of obtaining judicial review and thus would have been left without *any* judicial remedy for a right created by Congress. 358 U.S. at 190-191; see *id.* at 197 (Brennan, J., dissenting). This Court, however, has recognized that where Congress *has* provided an avenue of judicial review, that avenue must be followed; as a result, claims of unlawful agency action must be resolved in the manner, time, and forum ordained by Congress. *E.g.*, *Whitney Nat'l Bank* v. *Bank of New Orleans & Trust Co.*, 379

U.S. 411, 419-423 (1965). For that reason, most other courts of appeals—contrary to the decision below—have consistently rejected invocation of jurisdiction under *Leedom* v. *Kyne* where Congress has provided alternative means of judicial review of agency action.[21]

Here, Congress has provided companies in MCorp's position an adequate means of obtaining judicial review over any question pertaining to an exercise of the Board's regulatory enforcement power or authority that has binding legal effect. Section 1818(i)(1) is not a "jurisdictional bar." J.A. 22. Rather, that statute provides only that no court shall have jurisdiction to affect any notice or order issued under FISA, "*except* as otherwise provided in [12 U.S.C. 1818]." 12 U.S.C. 1818(i)(1) (emphasis added). Section 1818, in turn, provides for plenary review of final cease-and-desist orders, stating that any party subject to an order issued after a final decision under FISA may petition for review of that order in the appropriate United States Court of Appeals. 12 U.S.C. 1818(h)(2). Once this jurisdiction is properly invoked, the court of appeals has exclusive jurisdiction to "affirm, modify, terminate, or set aside, in whole or in part, the order of the agency." 12 U.S.C. 1818(h)(2).

The court of appeals' assertion of jurisdiction under *Leedom* v. *Kyne* thus circumvents the elaborate scheme of judicial review ordained by Congress in FISA. And in so doing, the decision below improperly frustrates Congress's prerogative to set the time and choose the forum

[21] See, *e.g.*, *Telecommunications Research & Action Center* v. *FCC*, 750 F.2d 70, 78 (D.C. Cir. 1984); *Quivira Mining Co.* v. *EPA*, 728 F.2d 477, 484 (10th Cir. 1984), cert. denied, 474 U.S. 1055 (1986); *Compensation Dep't.* v. *Marshall*, 667 F.2d 336, 343-344 (3d Cir. 1981); *Nor-Am Agricultural Prods., Inc.* v. *Hardin*, 435 F.2d 1151, 1159-1160 (7th Cir. 1970) (en banc), cert. dismissed, 402 U.S. 935 (1971); but see *Greater Detroit Resource Recovery Auth. & Combustion Eng'g* v. *EPA*, 916 F.2d 317, 323 (6th Cir. 1990).

for determining the validity of the Board's cease-and-desist actions.

2. This Court has stressed that jurisdiction under *Leedom* v. *Kyne* may not be invoked merely to "review" agency action. Rather, such an exercise of jurisdiction is appropriate only where necessary to remedy action that is manifestly beyond the agency's delegated authority and thus in excess of the agency's jurisdiction. *E.g.*, *Brotherhood of Ry. & S.S. Clerks*, 380 U.S. at 659; *Boire* v. *Greyhound Corp.*, 376 U.S. at 481; *Leedom* v. *Kyne*, 358 U.S. at 188.

The decision below brushed aside this important limitation. Here, the court of appeals acknowledged (J.A. 32-33) that the Board's authority to promulgate and enforce its source of strength regulations ultimately turned on application of step two of the framework set forth in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), because Congress has not spoken to the precise issue at hand. But the very existence of such an issue under the *Chevron* framework presupposes that the agency therefore has the jurisdiction and delegated authority to construe the meaning of the statutory provision. See, *e.g.*, *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 292-293 (1988); *CFTC* v. *Schor*, 478 U.S. 833, 844 (1986).

In essence, the court of appeals assumed that *any* error in an agency's construction of a statute amounts to an *ultra vires* action subject to judicial review under *Leedom*. But in analogous circumstances, the Court has flatly rejected that notion:

> [I]f a discretion is vested in [an executive officer], and he is to act in the light of the facts he ascertains and the judgment he forms, a court cannot restrain him from acting on the ground that he has exceeded his jurisdiction by reason of an error either of fact or law which induced his conclusion. Plainly, therefore, the respondents are wrong in asserting that

as the facts set forth in their bill charge the [executive officer] with an error of law, he exceeded his authority.

Adams v. *Nagle*, 303 U.S. 532, 542 (1938); see also *Larson* v. *Domestic & Foreign Corp.*, 337 U.S. 682, 692-695 (1949) (government officer's tortious action is not necessarily beyond his delegated powers). The same principle holds true for purposes of determining the scope of jurisdiction under *Leedom*, particularly where, as here, Congress has delineated other precise avenues for judicial review of agency action.

Jurisdiction under *Leedom* is reserved for those rare instances where the agency violates a clear statutory prohibition. Compare *Leedom*, 358 U.S. at 187-189 (jurisdiction exercised where challenged administrative action was admittedly contrary to a specific, mandatory prohibition in agency's governing statute). Such circumstances are not present on this record. Rather, as the court of appeals itself recognized, the challenged administrative action is based on the Board's interpretation of statutory terms left undefined by Congress. J.A. 33 ("The Congress has not spoken clearly to what constitutes an unsafe or unsound [banking] practice, leaving the development of the phrase to the regulatory agencies."). Regardless of the validity of the Board's statutory interpretation, the Board had the delegated authority—indeed the obligation—to give substantive content to the statutory term "unsafe or unsound" banking practices. Right or wrong, the exercise of that authority—although ultimately subject to judicial review under the procedures set forth in FISA—may not be reviewed outside those procedures under the narrow exception set forth in *Leedom*.

3. In any event, since jurisdiction under *Leedom* v. *Kyne* is, as this Court recognized, exercised only to prevent an agency's *ultra vires* action from destroying otherwise legally cognizable rights, 358 U.S. at 190, such jurisdiction must be predicated on agency action that

has binding legal effect on the aggrieved party. The court of appeals, however, invoked *Leedom* even in the absence of legally binding agency action. In this case, the Board has only filed notices of charges and initiated administrative proceedings; the Board has not found that MCorp violated any federal law or regulation, nor has the Board issued a final cease-and-desist order directing MCorp to take any corrective measures. These preliminary steps are not the sort of final agency actions that constitute cognizable legal injury otherwise subject to judicial review. See *FTC* v. *Standard Oil Co.*, 449 U.S. 232 (1980); cf. *Lujan* v. *National Wildlife Federation*, 110 S. Ct. 3177, 3191 (1990) (under APA, "we intervene in the administration of the laws only when, and to the extent that, a specific 'final agency action' has an actual or immediately threatened effect"). In the absence of such an injury, *Leedom* v. *Kyne* offers scant support for federal courts to interfere with ongoing administrative proceedings, particularly where, as here, the lawfulness of such proceedings is fully reviewable upon issuance of a final agency decision (and where the statute, by precluding other avenues of judicial review, effectively calls for the exhaustion of administrative remedies).

4. Finally, if a court is to exercise jurisdiction under *Leedom*, the legal issues must be ripe for decision. Those issues must be fit for judicial review and not turn on unresolved factual matters or speculation about what the agency might do in the future. See generally *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 148-149 (1967); *Lujan* v. *National Wildlife Federation*, 110 S. Ct. at 3190-3191. Here, the court of appeals adverted to these concerns, but determined that the Board's authority to enforce the source of strength policy raises pure questions of law that do not require any further factual development. J.A. 25-26. The court of appeals' own analysis belies that determination.

The court of appeals concluded that an order enforcing the source of strength policy exceeds the Board's authority because it would "waste" the holding company's assets, fail to account for the company's separate corporate status, and destroy shareholder rights. J.A. 34. Nothing in the administrative record, however, supports such a conclusion; indeed, given the embryonic stage of the proceedings when the court intervened, there was no administrative record. Rather, the court assumed that any Board enforcement order, regardless of its terms, would have unduly adverse economic effects on the holding company. The economic effects of an enforcement order, however, cannot be evaluated in the absence of (1) a specific remedial order fixing the amount, timing, and terms of a source of strength asset transfer, and (2) an administrative record detailing the economic impact on the holding company. Thus, to the extent the court of appeals viewed the economic impact of a remedial order as relevant to the validity of the source of strength policy, that issue—on the court's own terms—was not ripe for judicial review under *Leedom*. Cf. *Williamson Planning Comm'n* v. *Hamilton Bank*, 473 U.S. 172, 199-200 (1985).

III. THE FEDERAL RESERVE BOARD HAS STATUTORY AUTHORITY TO PROMULGATE AND ENFORCE ITS SOURCE OF STRENGTH REGULATIONS

In invalidating the source of strength regulations, the court of appeals misconstrued the Federal Reserve Board's statutory authority, derived from the Financial Institutions Supervisory Act, the International Lending Supervision Act, and the Bank Holding Company Act, to supervise bank holding companies' activities regarding subsidiary banks—particularly where those activities may adversely affect bank safety. The decision below is inconsistent with Congress's delegation of supervisory power to the Board and impermissibly restricts the Board's delegated authority to exercise continuing control

and supervision of bank holding company practices that impair the stability of the Nation's banking system.

A. FISA and ILSA Authorize Promulgation And Enforcement Of The Board's Source Of Strength Regulations

The court of appeals correctly recognized—as a threshold matter—that "Congress has not spoken clearly to what constitutes an unsafe or unsound practice, leaving the development of the phrase to the regulatory agencies." J.A. 33; accord *Investment Co. Inst.* v. *FDIC*, 815 F.2d 1540, 1550 (D.C. Cir.), cert. denied, 484 U.S. 847 (1987).[22] Consequently, the Board's conclusion that failure to act as a source of strength to subsidiary banks constitutes an unsafe or unsound practice should be upheld unless it is an unreasonable or impermissible construction of the statute. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. at 844. The Board's source of strength policy is a reasonable and sound interpretation of its statutory duty under FISA to compel bank holding companies to cease and desist from "unsafe or unsound [banking] practices." 12 U.S.C. 1818(b)(1) and (3).

1. As originally enacted in 1966, FISA's authority to remedy unsafe banking practices did not extend to bank holding companies. In 1974, however, Congress expressly specified that this regulatory power "shall apply to any bank holding company." Pub. L. No. 93-495, Tit. I, § 110, 88 Stat. 1506 (codified at 12 U.S.C. 1818(b)(3)). In reporting out this legislation, the Senate Banking Committee explained that it

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[22] In considering FISA, Congress relied on the memorandum submitted by the then Chairman of the Federal Home Loan Bank Board, John Horne. Chairman Horne, in commenting on the proposed legislation, noted that the term "unsafe or unsound" practice would necessarily have a flexible application adapted to the circumstances of each case. 112 Cong. Rec. 26,474 (1966). See also 112 Cong. Rec. 25,007-25,008 (1966).

> believes that the principal concern of the Federal supervisory agencies in discharging their responsibilities under the Federal law should be with the soundness of affiliated financial institutions. It is clearly in the public interest that these institutions remain sound and viable whether operated independently or as part of a holding company system. The cease and desist authority that the Committee recommends will, among other things, help prevent or terminate practices which might result in significant damage to depositors or to public confidence in the financial system.

S. Rep. No. 902, 93d Cong., 2d Sess. 10 (1974). Accordingly, the Board has acted well within its delegated authority in determining that an unsafe bank holding company practice should be defined with reference to its impact on affiliated banks.

2. The Board has also reasonably determined that bank holding company activities (or failures to take steps) that allow subsidiary banks' capital reserves to fall below minimally acceptable standards constitute unsafe or unsound banking practices within the meaning of FISA. See 12 U.S.C. 1818(b). Subsidiary banks' safety and stability depend, in large measure, on their capital position. And as this Court has pointed out, "Congress has long regarded capital adequacy as a measure of bank safety." *First Lincolnwood Corp.*, 439 U.S. at 250. For that reason, in ILSA Congress has authorized the Board —and other federal banking regulatory agencies—to establish minimum capital levels for financial institutions under their supervision. See 12 U.S.C. 3907(a). Indeed, Congress has made plain that

> [f]ailure of a banking institution to maintain capital at or above its minimum level * * * may be deemed by the appropriate Federal banking agency, in its discretion, to constitute an unsafe and unsound practice within the meaning of [FISA, 12 U.S.C. 1818].

12 U.S.C. 3907(b).[23]

Where a parent holding company with available assets refuses to alleviate the unsafe condition of an undercapitalized subsidiary bank by making new capital investments, the holding company certainly impairs the soundness of that bank and increases the risk of damage to its depositors, which in turn undermines public confidence in the banking system. Indeed, a bank's ability to obtain capital support from its parent company—when needed—is essential to the bank's safety and soundess. The reason is apparent. It is difficult for a bank wholly or substantially owned by a holding company to raise needed capital through its own efforts. Other potential suppliers of new capital to the bank typically have little incentive to make long-term equity investments in an institution that would continue to be controlled and managed by the holding company. If a subsidiary bank's inadequate capital position is to be remedied, its parent

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[23] In ILSA, Congress thus spoke to the concern that "[i]f certain capital ratios were essential for sound banking operations, and if the Comptroller is unable to achieve them, then the Board should be given power to require them by a general rule or standard applicable to all banks." *First Lincolnwood Corp.*, 439 U.S. at 257 (Stevens, J., dissenting).

In ILSA, Congress gave the Board explicit authority to set capital standards for holding companies and to enforce those standards by means of cease-and-desist proceedings under FISA. Since Congress directed the Board to ensure the "soundness of affiliated financial institutions," S. Rep. No. 902, *supra*, at 10, in exercising its power under FISA, the Board cannot be faulted for concluding that its authority to regulate a holding company's capital reserves includes the authority to ensure that those capital reserves are used to protect the safety of subsidiary banks. Indeed, it is difficult to conceive of any other purpose for Congress's authorizing the Board to regulate a holding company's capital adequacy.

company ordinarily must provide the necessary additional capital.

3. The court of appeals' rejection of the Board's source of strength policy—on the grounds that a parent bank holding company cannot be required to ignore its own separate corporate status, see J.A. 33-35—collapses under analysis. First, had Congress intended that the Board uniformly observe a rigid distinction between holding companies and subsidiary banks, it would not have vested the Board with the power, under FISA, to rectify *holding company* practices that adversely affect *bank* safety.

Moreover, for purposes of assessing the effect of holding company conduct on the financial soundness of subsidiary banks, the strict separation of corporate entities demanded by the court of appeals' reasoning is belied by the economic realities of holding company operations. A holding company's subsidiary banks are—by definition—under the holding company's ownership or control. As expert observers have pointed out, a bank holding company under the current regulatory framework, in some respects, functions as a single economic entity.[24] The holding company may well be separately incorporated, but that separate corporate status does not prevent it from deriving considerable economic benefits from its subsidiary banks. Indeed, the holding company derives

[24] For example, then Chairman of the Federal Reserve Board, Paul Volcker, recently told Congress:

> "[T]he practical realities of the market place and the internal dynamics of a business organization under central direction drive bank holding companies to act . . . as one business entity, with the component parts drawing on each other for marketing and financial strength. Certainly the market conceives of a bank holding company and its components in that way. And if market participants tend to consider the bank holding company as an integrated entity, problems in one part of the system will inevitably be transmitted to other parts."

S. Rep. No. 19, 100th Cong., 1st Sess. 9 (1987); see also Mayne, *New Directions in Bank Holding Company Supervision*, 95 Banking L.J. 729, 730-732 (1978).

distinct commercial advantages from control of institutions that, through their power to accept federally insured deposit, have the ability to attract capital and to make profitable loans and investments. The Board's source of strength policy ensures that the relationship between the holding company and its banks does not become a one-way street permitting the holding company to derive the full benefit of federal deposit insurance and to maximize its own economic advantage without imposing correlative obligations to preserve bank safety or to prevent injury to depositors and the federal insurance system.

In any event, a key factual premise of the court of appeals' "separate corporation" analysis—that a transfer of funds from the holding company to a trouble subsidiary would amount to a wasting of the holding company's assets, see J.A. 34—is made from whole cloth. If such a transfer were to occur, the holding company would continue to control the bank after additional capital has been provided. The primary effect of this new capital is to give the bank additional protection against further losses, to increase public confidence in the institution, and thus to minimize the chance that the bank would be closed. Rather than depleting holding company resources, the anticipated result of the holding company's recapitalizaiton of a troubled subsidiary—and the purpose of the Board's policy—is the preservation of the bank as a going concern (often the most important asset of the parent company).

Moreover, in enacting FIRREA, Congress recently amended FISA's cease-and-desist authority to make clear that the Board is empowered to order holding companies to divest themselves of assets or "take such other action as [the Board] determines to be appropriate." Pub. L. No. 101-73, Tit. IX, § 902, 103 Stat. 450 (1989). In reporting out this legislation, the House Conference Committee explained that it "clarifies [a banking agency's authority] to order restitution or reimbursement" of a

subsidiary and to restrict "specific activities of a financial institution." H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 439 (1989). FIRREA's amendment to FISA, effective upon enactment and thus applicable to MCorp's current operations, thus confirms that the Board has broad authority to order disposition of assets or other actions deemed necessary to bank safety.

B. The BHCA Further Supports The Board's Promulgation And Enforcement Of The Source Of Strength Regulations

The Bank Holding Company Act—particularly its provision empowering the Board to consider the "future prospects" of subsidiary banks when approving acquisitions, 12 U.S.C. 1842(c)—further supports the Board's source of strength regulations. In *First Lincolnwood Corp.*, 439 U.S. at 249-252, this Court held that Section 3(c) of the BHCA, 12 U.S.C. 1842(c), authorizes the Board, when reviewing a proposed bank acquisition, to consider whether a holding company can act as a source of strength to a subsidiary bank. Here, the court of appeals, in light of *First Lincolnwood*, limited the reach of Section 1842(c) to the acquisition stage. See J.A. 29-31. That limitation is at odds with the statutory scheme of the BHCA, which vests the Board with broad powers to regulate holding companies' ongoing banking practices, and purports to render *First Lincolnwood* much ado about nothing.

1. At the outset, unless the Board can impose on holding companies a *continuing* obligation to act as sources of strength to subsidiary banks, the Board's undisputed power under Section 1842(c) to consider holding companies' resources when reviewing bank acquisitions would have virtually no impact on bank safety.[25] Such a state

[25] The court of appeals stated that "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial [s]oundness." J.A. 31-32 n.5. The court's equivocal statement offers the Board little solace, since the Board—under

of affairs would be inconsistent with the mandate of Section 1842(c) that requires the Board to consider the "future prospects" of banks that may come under the holding company's control. Indeed, the Board's express statutory power to base the approval of a bank acquisition on the holding company's *ability* to protect the capital position of a proposed subsidiary would be nullified if the holding company has no continuing obligation to *fulfill* that requirement once the bank acquisition is completed.

We recognize that Section 1842(c), by its terms, does not empower the Board to consider the holding company's continuing compliance with the terms and conditions of the acquisition. Nonetheless, the Board, under 12 U.S.C. 1844(b), has express authority to "issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of [the BHCA] and *prevent evasions thereof*" (emphasis added). Accordingly, the Board may reasonably regard a holding company's failure to adhere to the requirements governing its initial acquisition as an evasion of the purposes of the BHCA—an evasion that is remediable as an unsafe and unsound banking practice under FISA, 12 U.S.C. 1818(b)(1).[26]

2. The entire statutory scheme and the BHCA governing the Board's authority over holding companies reflects

the court's holding—would still lack any statutory basis for enforcing the source of strength policy against the thousands of banks that are already under holding company control.

[26] As originally enacted, the BHCA's restrictions on the transfer of funds among holding company affiliates did not expressly except regulatory orders mandating recapitalization of deficient banks. Bank Holding Company Act of 1956, ch. 240, § 6, 70 Stat. 137, repealed by Act of July 1, 1966, Pub. L. No. 89-485, § 9, 80 Stat. 240. But that is no indication that Congress intended to deprive the Board of authority under FISA to require such recapitalization in appropriate circumstances. Congress designed the now-repealed BHCA restrictions on inter-company transactions only to prevent a holding company from initiating transactions that unduly disadvantaged the resources of the subsidiary bank. See S. Rep. No. 1095, 84th Cong., 1st Sess. Pt. 1, at 15 (1955).

Congress's intent that the Board exercise ongoing supervisory powers over holding company operations that affect the stability of subsidiary banks. Accordingly, Congress gave the Board power to examine the financial transactions and records of each holding company and subsidiary, see 12 U.S.C. 1844(c)—a power this Court has characterized as "perhaps the most effective weapon of federal regulation of banking." *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 329 (1963). In addition, Congress authorized the Board to curtail holding companies' ability to engage in "nonbank" activities that pose risks to the financial stability of subsidiary banks. See 12 U.S.C. 1843, 1844(e).

These statutory provisions—among others[27]—show that Congress plainly intended to vest the Board with broad and substantial powers to regulate holding company practices that bear directly on the day-to-day integrity of banking subsidiaries. Cf. *Toilet Goods Ass'n* v. *Gardner*, 387 U.S. 158, 163 (1967). The Board's source of strength regulations thus further Congress's overarching objective of "assur[ing] that financial institutions are not endangered with respect to activities engaged in by parent holding companies." S. Rep. No. 902, *supra*, at 10.

C. Congress's Repeal Of Shareholder Assessment Provisions Of The National Bank Act Does Not Undermine The Validity Of The Board's Source Of Strength Regulations

MCorp contends (90-913 Br. in Opp. 5-9) that the so-called "shareholder assessment" provisions of the National Banking Act, which Congress repealed over 30 years ago, show that Congress had no intention of con-

[27] As mentioned above, under ILSA, the Board has authority to establish minimum capital requirements for holding companies where necessary to promote bank safety. See 12 U.S.C. 3907, 3909(a)(2); 12 C.F.R. 263.35-263.40. And under FISA, the Board can order holding companies to cease and desist from engaging in unsafe banking practices. See 12 U.S.C. 1818(b).

ferring similar authority on the Board under the guise of source of strength regulations. That contention is wide of the mark.

First, actions of the Congresses that repealed provisions of the National Bank Act have no bearing on this case, since those Congresses assuredly did not enact the statutory provisions at issue, namely, the pertinent aspects of the BHCA, FISA, and ILSA. See pp. 2-6, *supra*. Second, MCorp's equating the regulatory regimes of "shareholder assessment" and source of strength is a sleight of hand. Under the National Bank Act, shareholder assessments were to be collected only after the bank had failed, in order to reduce losses incurred by the bank's creditors.[28] The Board's source of strength policy, in stark contrast, is remedial. That policy seeks to prevent bank failures—and the resulting losses to depositors and other creditors—by requiring the bank's parent holding company to provide needed capital before the bank fails.

[28] See Act of June 3, 1864, ch. 106, §§ 12, 50, 13 Stat. 102-103, 114-115; see also Act of Dec. 23, 1913, ch. 6, § 25, 38 Stat. 273.

CONCLUSION

The judgment of the court of appeals vacating the district court's injunction with respect to proceedings on the Board's Section 23A charges should be affirmed. The judgment of the court of appeals remanding the case with instructions to enjoin proceedings on the Board's source of strength charges should be reversed.

Respectfully submitted.

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APPENDIX

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 3(a) of the Bank Holding Company Act of 1956, 12 U.S.C. 1842(a):

> **Prior approval of Board as necessary; exceptions; disposition, time extension; subsequent approval or disposition upon disapproval**
>
> It shall be unlawful, except with the prior approval of the Board, (1) for any action to be taken that causes any company to become a bank holding company; (2) for any action to be taken that causes a bank to become a subsidiary of a bank holding company; (3) for any bank holding company to acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, such company will directly or indirectly own or control more than 5 per centum of the voting shares of such bank; (4) for any bank holding company or subsidiary thereof, other than a bank, to acquire all or substantially all of the assets of a bank; or (5) for any bank holding company to merge or consolidate with any other bank holding company. Notwithstanding the foregoing this prohibition shall not apply to (A) shares acquired by a bank, (i) in good faith in a fiduciary capacity, except where such shares are held under a trust that constitutes a company as defined in section 1841(b) of this title and except as provided in paragraphs (2) and (3) of section 1841(g) of this title, or (ii) in the regular course of secur-

ing or collecting a debt previously contracted in good faith, but any shares acquired after May 9, 1956, in securing or collecting any such previously contracted debt shall be disposed of within a period of two years from the date on which they were acquired; or (B) additional shares acquired by a bank holding company in a bank in which such bank holding company owned or controlled a majority of the voting shares prior to such acquisition. The Board is authorized upon application by a bank to extend, from time to time for not more than one year at a time, the two-year period referred to above for disposing of any shares acquired by a bank in the regular course of securing or collecting a debt previously contracted in good faith, if, in the Board's judgment, such an extension would not be detrimental to the public interest, but no such extension shall in the aggregate exceed three years. For the purpose of the preceeding sentence, bank shares acquired after December 31, 1970, shall not be deemed to have been acquired in good faith in a fiduciary capacity if the acquiring bank or company has sole discretionary authority to exercise voting rights with respect thereto but in such instances acquisitions may be made without prior approval of the Board if the Board, upon application filed within ninety days after the shares are acquired, approves retention or, if retention is disapproved, the acquiring bank disposes of the shares or its sole discretionary voting rights within two years after issuance of the order of disapproval.

Section 3(c) of the Bank Holding Company Act of 1956, 12 U.S.C. 1842(c):

Factors governing determination of application for approval

The Board shall not approve—

(1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or

(2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint [of] trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served. Notwithstanding any other provision of law, the Board shall not follow any practice or policy in the consideration of any application for the formation of a one-bank holding company if following such practice or policy would result in the rejection of such application solely because the transaction to form such one-bank holding company involves a bank stock loan which is for a

period of not more than twenty-five years. The previous sentence shall not be construed to prohibit the Board from rejecting any application solely because the other financial arrangements are considered unsatisfactory. The Board shall consider transactions involving bank stock loans for the formation of a one-bank holding company having a maturity of twelve years or more on a case by case basis and no such transaction shall be approved if the Board believes the safety or soundness of the bank may be jeopardized.

Section 5 of the Bank Holding Company Act of 1956, 12 U.S.C. 1844:

Administration

(a) Registration of bank holding company

Within one hundred and eighty days after May 9, 1956, or within one hundred and eighty days after becoming a bank holding company, whichever is later, each bank holding company shall register with the Board on forms prescribed by the Board which shall include such information with respect to the financial condition and operations, management, and intercompany relationships of the bank holding company and its subsidiaries, and related matters, as the Board may deem necessary or appropriate to carry out the purposes of this chapter. The Board may, in its discretion, extend the time within which a bank holding company shall register and file the requisite information.

(b) Regulations and orders

The Board is authorized to issue such regulations and orders as may be necessary to enable

it to administer and carry out the purposes of this chapter and prevent evasions thereof.

(c) Reports required by Board; examinations; cost of examination

The Board from time to time may require reports under oath to keep it informed as to whether the provisions of this chapter and such regulations and orders issued thereunder have been complied with; and the Board may make examinations of each bank holding company and each holding company and each subsidiary thereof, the cost of which shall be assessed against, and paid by, such holding company. The Board shall, as far as possible, use the report of examinations made by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the appropriate State bank supervisory authority for the purposes of this section.

(d) Reports to the Congress; recommendations

Before the expiration of two years following May 9, 1956, and each year thereafter in the Board's annual report to the Congress, the Board shall report to the Congress the results of the administration of this chapter, stating what, if any, substantial difficulties have been encountered in carrying out the purposes of this chapter, and any recommendations as to changes in the law which in the opinion of the Board would be desirable.

(e) Termination of activities or ownership or control of nonbank subsidiaries constituting serious risk

(1) Notwithstanding any other provision of this chapter, the Board may, whenever it has reasonable cause to believe that the continuation by a bank holding company of any activity or of ownership or control of any of its nonbank subsidiaries, other than a nonbank subsidiary of a bank constitutes a serious risk to the financial safety, soundness, or stability of a bank holding company subsidiary bank and is inconsistent with sound banking principles or with the purposes of this chapter or with the Financial Institutions Supervisory Act of 1966, order the bank holding company or any such nonbank subsidiaries, after due notice and opportunity for hearing, and after considering the views of the bank's primary supervisor, which shall be the Comptroller of the Currency in the case of a national bank or the Federal Deposit Insurance Corporation and the appropriate State supervisory authority in the case of an insured nonmember bank, to terminate such activities or to terminate (within one hundred and twenty days or such longer period as the Board may direct in unusual circumstances) its ownership or control of any such subsidiary either by sale or by distribution of the shares of the subsidiary to the shareholders of the bank holding company. Such distribution shall be pro rata with respect to all of the shareholders of the distributing bank holding company, and the holding company shall not make any charge to its shareholders arising out of such a distribution.

(2) The Board may in its discretion apply to the United States district court within the jurisdiction of which the principal office of the holding company is located, for the enforcement of any effective and outstanding order issued under this section, and such court shall have jurisdiction and power to order and require compliance therewith, but except as provided in section 1848 of this title, no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify suspend, terminate, or set aside any such notice or order.

(f) Powers of Board respecting applications, examinations, or other proceedings

In the course of or in connection with an application, examination, investigation or other proceeding under this chapter, the Board, or any member or designated representative thereof, including any person designated to conduct any hearing under this chapter, shall have the power to administer oaths and affirmations, to take or cause to be taken depositions, and to issue, revoke, quash, or modify subpenas and subpenas duces tecum; and the Board is empowered to make rules and regulations to effectuate the purpose of this subsection. The attendance of witnesses and the production of documents provided for in this subsection may be required from any place in any State or in any territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. Any party to proceedings under this chapter may apply to the

United States District Court for the District of Columbia, or the United States district court for the judicial district or the United States court in any territory in which such proceeding is being conducted or where the witness resides or carries on business, for the enforcement of any subpena or subpena duces tecum issued pursuant to this subsection, and such courts shall have jurisdiction and power to order and require compliance therewith. Witnesses subpenaed under this subsection shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States. Any service required under this subsection may be made by registered mail, or in such other manner reasonably calculated to give actual notice as the Board may by regulation or otherwise provide. Any court having jurisdiction of any proceeding instituted under this subsection may allow to any such party such reasonable expenses and attorneys' fees as it deems just and proper. Any person who willfully shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, arguments, or other records, if in such person's power so to do, in obedience to the subpena of the Board, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year or both.

The Financial Institutions Supervisory Act, 12 U.S.C. 1818, provides in pertinent part:

Termination of status as insured bank

(a) Notice by bank of intention; citation of bank for unsound practices or violations, hearings; judicial review

Any insured bank (except a national member bank, a foreign bank having an insured branch which is a Federal branch, a foreign bank having an insured branch which is required to be insured under section 3104(a) or (b) of this title or State member bank) may, upon not less than ninety days' written notice to the Corporation terminate its status as an insured bank. Whenever the Board of Directors shall find that an insured bank or its directors or trustees have engaged or are engaging in unsafe or unsound practices in conducting the business of such bank, or is in an unsafe or unsound condition to continue operations as an insured bank, or violated an applicable law, rule, regulation or order, or any condition imposed in writing by the Corporation in connection with the granting of any application or other request by the bank, or any written agreement entered into with the Corporation the Board of Directors shall first give to the Comptroller of the Currency in the case of a national bank or a district bank, to the Federal Home Loan Bank Board in the case of an insured Federal savings bank, to the authority having supervision of the bank in the case of a State bank and to the Board of Governors of the Federal Reserve System in the case of a State member bank, a statement with respect to such practices or violations for the purpose of securing the correction thereof and shall give a

copy thereof to the bank. Unless such correction shall be made within one hundred and twenty days, or such shorter period not less than twenty day fixed by the Corporation in any case where the Board of Directors in its discretion has determined that the insurance risk of the Corporation is unduly jeopardized or fixed by the Comptroller of the Currency in the case of a national bank, or the Federal Home Loan Bank Board in the case of an insured Federal savings bank, or the State authority in the case of a State bank, or Board of Governors of the Federal Reserve System in the case of a State member bank as the case may be, the Board of Directors, if it shall determine to proceed further shall give to the bank not less than thirty days' written notice of intention to terminate the status of the bank as an insured bank, and shall fix a time and place for a hearing before the Board of Directors or before a person designated by it to conduct such hearing, at which evidence may be produced, and upon such evidence the Board of Directors shall make written findings which shall be conclusive. If the Board of Directors shall find that any unsafe or unsound practice or condition or violation specified in such statement has been established and has not been corrected within the time above prescribed in which to make such corrections, the Board of Directors may order that the insured status of the bank be terminated on a date subsequent to such finding and to the expiration of the time specified in such notice intention. Unless the bank shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the termination of its status as an insured bank and termination of such status thereupon

may be ordered. Any insured bank whose insured status has been terminated by order of the Board of Directors under this subsection shall have the right of judicial review of such order only to the same extent as provided for the review of orders under subsection (h) of this section. The Corporation may publish notice of such termination and the bank shall give notice of such termination to each of its depositors at his last address of record on the books of the bank, in such manner and at such time as the Board of Directors may find to be necessary and may order for the protection of depositors. After the termination of the insured status of any bank under the provisions of this subsection, the insured deposits of each depositor in the bank on the date of such termination, less all subsequent withdrawals from any deposits of such subsequent withdrawals from any deposits of such depositor shall continue for a period of two years to be insured, and the bank shall continue to pay to the Corporation assessments as in the case of an insured bank during such period. No additions to any such deposits and no new deposits in such bank made after the date of such termination shall be insured by the Corporation, and the bank shall not advertise or hold itself out as having insured deposits unless in the same connection it shall also state with equal prominence that such additions to deposits and new deposits made after such date are not so insured. Such bank shall, in all other respects, be subject to the duties and obligations of an insured bank for the period of two years from the date of such termination, and in the event that such bank shall be closed on account of inability

to meet the demands of its depositors within such period of two years, the Corporation shall have the same powers and rights with respect to such bank as in case of an insured bank.

(b) Cease-and-desist proceedings

(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to engage in an unsafe or unsound practice in conducting the business of such bank, or is violating or has violated, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency in connection with the granting of any application or other request by the bank or any written agreement entered into with the agency, the agency may issue and serve upon the bank or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom

should issue against the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the agency at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

(2) A cease-and-desist order shall become effective at the expiration of thirty days after the service of such order upon the bank or other person concerned (except in the case of a cease-and-desist order issued upon consent which shall become effective at the time specified therein), and shall remain effective and enforceable as pro-

vided therein, except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

(3) This subsection and subsections (c) through (f) and (h) through (n) of this section shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956 [12 U.S.C. 1841 *et seq.*], and to any organization organized and operated under section 25(a) of the Federal Reserve Act [12 U.S.C. 611 *et seq.*] or operating under section 25 of the Federal Reserve Act [12 U.S.C. 601 *et seq.*], in the same manner as they apply to a State member insured bank. Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency, other than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank).

(4) This subsection and subsections (c), (d), (h), (i), (k), (l), (m), and (n) of this section shall apply to any foreign bank or company to which subsection (a) of section 3106 of this title applies and to any subsidiary other than a bank) of any such foreign bank or company in the same manner as they apply to a bank holding company and any subsidiary thereof (other than a bank) under subparagraph (3) of this subsection. For the purposes of this paragraph, the term "subsidiary" shall have the meaning assigned to it in section 2 of the Bank Holding Company Act of 1956 [12 U.S.C. 1841].

(5) This section shall apply, in the same manner as it applies to any insured bank for which the appropriate Federal banking agency is the Comptroller of the Currency, to any national banking association chartered by the Comptroller of the Currency, including an uninsured association.

(c) Temporary cease-and-desist orders

(1) Whenever the appropriate Federal banking agency shall determine that the violation or threatened violation or the unsafe or unsound practice or practices, specified in the notice of charges served upon the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank pursuant to paragraph (1) of subsection (b) of this section, or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors prior to the completion of the proceedings conducted pursuant to paragraph (1) of subsection (b) of this section, the agency may issue a temporary order requiring the bank or such director, officer, employees, agent, or other person to cease and desist from any such violation or practice and to take affirmative action to prevent such insolvency, dissipation, condition, or prejudice pending completion of such proceedings. Such order shall become effective upon service upon the bank or such director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank and, un-

less set aside, limited, or suspended by a court in proceedings authorized by paragraph (2) of this subsection, shall remain effective and enforceable pending the completion of the administration proceedings pursuant to such notice and until such time as the agency shall dismiss the charges specified in such notice, or if a cease-and-desist order is issued against the bank or such director, officer, employee, agent, or other person, until the effective date of such order.

(2) Within ten days after the bank concerned or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank has been served with a temporary cease-and-desist order, the bank or such director, officer, employee, agent, or other person may apply to the United States district court for the judicial district in which the home office of the bank is located, or the United States District Court for the District of Columbia, for an injunction setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings pursuant to the notice of charges served upon the bank or such director, officer, employee, agent, or other person under paragraph (1) of subsection (b) of this section, and such court shall have jurisdiction to issue such injunction.

(d) Temporary cease-and-desist orders; enforcement

In the case of violation or threatened violation of, or failure to obey, a temporary case-and-desist order issued pursuant to paragraph (1)

of subsection (c) of this section, the appropriate Federal banking agency may apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for an injunction to enforce such order, and, if the court shall determine that there has been such violation or threatened violation or failure to obey it shall be the duty of the court to issue such injunction.

* * * * *

(h) Hearings and judicial review

(1) Any hearing provided for in this section (other than the hearing provided for in subsection (g)(3) of this section) shall be held in the Federal judicial district or in the territory in which the home office of the bank is located unless the party afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5. Such hearing shall be private, unless the appropriate Federal banking agency, in its discretion, after fully considering the views of the party afforded the hearing, determines that a public hearing is necessary to protect the public interest. After such hearing, and within ninety days after the appropriate Federal banking agency or Board of Governors of the Federal Reserve System has notified the parties that the case has been submitted to it for final decision, it shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and serve upon each party to the proceedings an order or orders consistent with the provisions of this section. Judicial review of any

such order shall be exclusively as provided in this subsection (h). Unless a petition for review is timely filed in a court of appeals of the United States, as hereinafter provided in paragraph (2) of this subsection, and thereafter until the record in the proceeding has been filed as so provided, the issuing agency may at any time, upon such notice and in such manner as it shall deem proper, modify, terminate, or set aside any such order. Upon such filing of the record, the agency may modify, terminate, or set aside any such order with permission of the court.

(2) Any party to the proceeding, or any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order served pursuant to paragraph (1) of this subsection (other than an order issued with the consent of the bank or the director or officer or other person concerned, or an order issued under paragraph (1) of subsection (g) of this section) by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the agency be modified, terminated, or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the agency, and thereupon the agency shall file in the court the record in the proceeding, as provided in section 2112 of title 28. Upon the filing of such petition, such court shall have jurisdiction, which

upon the filing of the record shall except as provided in the last sentence of said paragraph (1) be exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency. Review of such proceedings shall be had as provided in chapter 7 of title 5. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 1254 of title 28.

(3) The commencement of proceedings for judicial review under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of any order issued by the agency.

(i) Jurisdiction and enforcement; penalty

(1) The appropriate Federal banking agency may in its discretion apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

(2)(i) Any insured bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such a bank who violates the terms of any

order which has become final and was issued pursuant to subsection (b), (c), or (s) of this section, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues: Provided, That the agency having authority to impose a civil money penalty may, in its discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under such authority. The penalty may be assessed and collected by the appropriate Federal banking agency by written notice. As used in this section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

(ii) In determining the amount of the penalty the appropriate Federal banking agency shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the insured bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

(iii) The insured bank or person assessed shall be afforded an opportunity for agency hearing, upon request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of title 5. The agency determination shall be made by final order which may be reviewed only as provided in subparagraph (iv). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

(iv) Any insured bank or person against whom an order imposing a civil money penalty has been entered after agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the insured bank is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within twenty days from the service of such order, and simultaneously sending a copy of such notice by registered or certified mail to the appropriate Federal banking agency. The agency shall promptly certify and file in such Court the record upon which the penalty was imposed, as provided in section 2112 of title 28. The findings of the agency shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of title 5.

(v) If any insured bank or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the agency shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

(vi) Each Federal banking agency shall promulgate regulations establishing procedures necessary to implement this paragraph.

* * * * *

(k) Definitions

As used in this section (1) the terms "cease-and-desist order which has become final" and "order which has become final" mean a cease-and-desist order, or an order, issued by the appropriate Federal banking agency with the consent of the bank or the director or officer or other person concerned, or with respect to which no petition for review of the action of the agency has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (h) of this section, or with respect to which the action of the court in which said petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in said paragraph, or an order issued under paragraph (1) or (3) of subsection (g) of this section, and (2) the term "violation" includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

Section 902 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, Tit. IX, 103 Stat. 450-453 (amending 12 U.S.C. 1818(b) and (c)), provides in pertinent part:

Amendments To Cease And Desist Authority With Respect To Restitution, Restrictions On Specific Activities, Grounds For Issuance Of a Temporary Order, And Incomplete Or Inaccurate Records

(a) *Depository Institutions Insured By The FDIC.*—

(1) *Cease And Desist Authority.*—Section 8 (b) of the *Federal Deposit Insurance Act* (12 U.S.C. 1818(b)) is amended—

(A) in paragraph (3), by striking out "subsections (c) through (s) and subsection (u)";

(B) in paragraph (4), by striking out "subsections (c) through (f) and (h) through (n)" and inserting in lieu thereof "subsections (c) through (s) and subsection (u)"; and

(C) by adding at the end thereof the following new paragraphs:

"(6) *Affirmative Action To Correct Conditions Resulting From Violations or Practices.*—The Authority to issue an order under this subsection and subsection (c) which requires an insured depository institution or any institution-affiliated party to take affirmative action to correct any conditions resulting from any violation or practice with respect to which such order is issued includes the authority to require such depository institution or such party to—

"(A) make restitution or provide reimbursement, indemnification, or guarantee against loss if—

"(i) such depository institution or such party was unjustly enriched in connection with such violation or practice; or

"(ii) the violation or practice involved a reckless disregard for the law or any applicable regulations or prior order of the appropriate Federal banking agency;

"(B) restrict the growth of the institution;

"(C) dispose of any loan or asset involved;

"(D) rescind agreements or contracts; and

"(E) employ qualified officers or employees (who may be subject to approval by the appropriate Federal banking agency at the direction of such agency); and

"(F) take such other action as the banking agency determines to be appropriate.

"(7) *Authority To Limit Activities.*—The authority to issue an order under this subsection or subsection (c) includes the authority to place limitations on the activities or functions of an insured depository institution or any institution-affiliated party.

"(8) *Expansion of Authority To Savings And Loan Affiliates And Entities.*—Subsections (a) through (s) and subsection (u) shall apply to any savings and loan holding company and to any subsidiary (other than a bank or subsidiary of that bank) of a savings and loan holding company, to any service corporation of a savings association and to any subsidiary of such service corporation, whether wholly or partly owned, in the same manner as such subsections apply to a savings association."

(2) *Temporary Cease And Desist Authority.*—Section 8(c) of the Federal Deposit Insurance Act (12 U.S.C. 1818(c)) is amended—

(A) in paragraph (1)—

(i) by striking out "substantial" and inserting in lieu thereof "significant";

(ii) by striking out "seriously" each place such term appears; and

(iii) by inserting after the 1st sentence the following new sentence: "Such order may include any requirement authorized under subsection (b)(6)(B)."; and

(B) by adding at the end thereof the following new paragraph:

"(3) *Incomplete Or Inaccurate Records.*—

"(A) *Temporary Order.*—If a notice of charges served under subsection (b)(1) specifies, on the basis of particular facts and circumstances, that an insured depository institution's books and records are so incomplete or inaccurate that the appropriate Federal banking agency is unable, through the normal supervisory process, to determine the financial condition of that depository institution or the details or purpose of any transaction or transactions that may have a material effect on the financial condition of that depository institution, the agency may issue a temporary order requiring—

"(i) the cessation of any activity or practice which gave rise, whether in whole or in part, to the incomplete or inaccurate state of the books or records; or

"(ii) affirmative action to restore such books or records to a complete and accurate state, until the completion of the proceedings under subsection (b)(1).

"(B) *Effective period.*—Any temporary order issued under subparagraph (A)—

"(i) shall become effective upon service and

"(ii) unless set aside, limited, or suspended by a court in proceedings under paragraph (2), shall remain in effect and enforceable until the earlier of—

"(I) the completion of the proceeding initiated under subsection (b)(1) in connection with the notice of charges; or

"(II) the date the appropriate Federal banking agency determines, by examination or otherwise, that the insured depository institution's books and records are accurate and reflect the financial condition of the depository institution.".

Section 908 of the International Lending Supervision Act of 1983, 12 U.S.C. 3907:

Capital adequacy

(a)(1) Each appropriate Federal banking agency shall cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by using such other methods as the appropriate Federal banking agency deems appropriate.

(2) Each appropriate Federal banking agency shall have the authority to establish such minimum level of capital for a banking institution

as the appropriate Federal banking agency, in its discretion, deems to be necessary or appropriate in light of the particular circumstances of the banking institution.

(b)(1) Failure of a banking institution to maintain capital at or above its minimum level as established pursuant to subsection (a) of this section may be deemed by the appropriate Federal banking agency, in its discretion, to constitute an unsafe and unsound practice within the meaning of section 1818 of this title.

(2)(A) In addition to, or in lieu of, any other action authorized by law, including paragraph (1), the appropriate Federal banking agency may issue a directive to a banking institution that fails to maintain capital at or above its required level as established pursuant to subsection (a) of this section.

(B)(i) Such directive may require the banking institution to submit and adhere to a plan acceptable to the appropriate Federal banking agency describing the means and timing by which the banking institution shall achieve its required capital level.

(ii) Any such directive issued pursuant to this paragraph, including plans submitted pursuant thereto, shall be enforceable under the provisions of section 1818(i) of this title to the same extent as an effective and outstanding order issued pursuant to section 1818(b) of this title which has become final.

(3)(A) Each appropriate Federal banking agency may consider such banking institution's progress in adhering to any plan required under this subsection whenever such banking institu-

tion, or an affiliate thereof, of the holding company which controls such banking institution, seeks the requisite approval of such appropriate Federal banking agency for any proposal which would divert earnings, diminish capital or otherwise impede such banking institution's progress in achieving its minimum capital level.

(B) Such appropriate Federal banking agency may deny such approval where it determines that such proposal would adversely affect the ability of the banking institution to comply with such plan.

(C) The Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury shall encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending.

Section 910 of the International Lending Supervision Act of 1983, 12 U.S.C. 3909, provides in pertinent part:

General Authorities

(a) Rules and regulations

(1) The appropriate Federal banking agencies are authorized to interpret and define the terms used in this chapter, and each appropriate Federal banking agency shall prescribe rules or regulations or issue orders as necessary to effectuate the purposes of this chapter and prevent evasions thereof.

(2) The appropriate Federal banking agency is authorized to apply the provisions of this chapter to any affiliate of an insured bank, but only to affiliates for which it is the appropriate Federal banking agency, in order to promote uniform application of this chapter or to prevent evasions thereof.

(3) For purposes of this section, the term "affiliate" shall have the same meaning as in section 371c of this title, except that the term "member bank" in such section shall be deemed to refer to an "insured bank," as such term is used in section 1813(h) of this title.

* * * * *

(c) Existing authorities

(1) The powers and authorities granted in this chapter shall be supplemental to and shall not be deemed in any manner to derogate from or restrict the authority of each appropriate Federal banking agency under section 1818 of this title or any other law including the authority to require additional capital or reserves.

(2) Any such authority may be used by any appropriate Federal banking agency to ensure compliance by a banking institution with the provisions of this chapter and all rules, regulations, or orders issued pursuant thereto.

* * * * *

Section 23A of the Federal Reserve Act, 12 U.S.C. 371c:

Banking affiliates

(a) Restrictions on transactions with affiliates

(1) A member bank and its subsidiaries may engage in a covered transaction with an affiliate only if—

(A) in the case of any affiliate, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 10 per centum of the capital stock and surplus of the member bank; and

(B) in the case of all affiliates, the aggregate amount of covered transactions of the member bank and its subsidiaries will not exceed 20 per centum of the capital stock and surplus of the member bank.

(2) For the purpose of this section, any transaction by a member bank with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate.

(3) A member bank and its subsidiaries may not purchase a low-quality asset from an affiliate unless the bank or such subsidiary, pursuant to an independent credit evaluation, committed itself to purchase such asset prior to the time such asset was acquired by the affiliate.

(4) Any covered transactions and any transactions exempt under subsection (d) of this section between a member bank and an affiliate shall be on terms and conditions that are consistent with safe and sound banking practices.

(b) Definitions

For the purpose of this section—

(1) the term "affiliate" with respect to a member bank means—

(A) any company that controls the member bank and other company that is controlled by the company that controls the member bank;

(B) a bank subsidiary of the member bank;

(C) any company—

(i) that is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the member bank or any company that controls the member bank; or

(ii) in which a majority of its directors or trustees constitute a majority of the persons holding any such office with the member bank or any company that controls the member bank;

(D)(i) any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the member bank or any subsidiary or affiliate of the member bank; or

(ii) any investment company with respect to which a member bank or any affiliate thereof is an investment advisor as defined in section 80a-2(a)(20) of title 15; and

(E) any company that the Board determines by regulation or order to have a relationship with the member bank or any subsidiary or affiliate of the member bank, such that covered transactions by the member bank or its subsidiary with that company may be affected by the relationship to

the detriment of the member bank or its subsidiary; and

(2) the following shall not be considered to be an affiliate:

(A) any company, other than a bank, that is a subsidiary of a member bank, unless a determination is made under paragraph (1)(E) not to exclude such subsidiary company from the definition of affiliate;

(B) any company engaged solely in holding the premises of the member bank;

(C) any company engaged solely in conducting a safe deposit business;

(D) any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and

(E) any company where control results from the exercise of rights arising out of a bona fide debt previously contracted, but only for the period of time specifically authorized under applicable State or Federal law or regulation or, in the absence of such law or regulation, for a period of two years from the date of the exercise of such rights or the effective date of this Act, whichever date is later, subject, upon application, to authorization by the Board for good cause shown of extensions of time for not more than one year at a time, but such extensions in the aggregate shall not exceed three years;

(3)(A) a company or shareholder shall be deemed to have control over another company if—

(i) such company or shareholder, directly or indirectly, or acting through one or more other persons owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the other company;

(ii) such company or shareholder controls in any manner the election of a majority of the directors or trustees of the other company; or

(iii) the Board determines, after notice and opportunity for hearing, that such company or shareholder, directly or indirectly over the management or policies of the other company; and

(B) notwithstanding any other provision of this section, no company shall be deemed to own or control another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in paragraph (1)(C) of this subsection or if the company owning or controlling such shares is a business trust;

(4) the term "subsidiary" with respect to a specified company means a company that is controlled by such specified company;

(5) the term "bank" includes a State bank, national bank, banking association, and trust company;

(6) the term "company" means a corporation, partnership, business trust, association, or similar organization and, unless specifically excluded, the term "company" includes a "member bank" and a "bank";

(7) the term "covered transaction" means with respect to an affiliate of a member bank—

(A) a loan or extension of credit to the affiliate;

(B) a purchase of or an investment in securities issued by the affiliate;

(C) a purchase of assets, including assets subject to an agreement to repurchase, from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Board by order or regulation;

(D) the acceptance of securities issued by the affiliate as collateral security for a loan or extension of credit to any person or company; or

(E) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate;

(8) the term "aggregate amount of covered transactions" means the amount of the covered transactions about to be engaged in added to the current amount of all outstanding covered transactions:

(9) the term "securities" means stocks, bonds, debentures, notes, or other similar obligations; and

(10) the term "low-quality asset" means an asset that falls in any one or more of the following categories:

(A) an asset classified as "substandard", "doubtful", or "loss" or treated as "other loans especially mentioned" in the most recent report of examination or inspection of an affiliate prepared by either a Federal or State supervisory agency;

(B) as asset in a nonaccrual status;

(C) an asset on which principal or interest payments are more than thirty days past due; or

(D) an asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

(c) Collateral for certain transactions with affiliates

(1) Each loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate by a member bank or its subsidiary shall be secured at the time of the transaction by collateral having a market value equal to—

(A) 100 per centum of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit, if the collateral is composed of—

(i) obligations of the United States or its agencies;

(ii) obligations fully guaranteed by the United States or its agencies as to principal and interest;

(iii) notes, drafts, bills of exchange or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or

(iv) a segregated, earmarked deposit account with the member bank;

(B) 110 per centum of the amount of such loan or extension of credit, guarantee, aceptance, or letter of credit if the collateral is composed of obligations of any State or political subdivision of any State;

(C) 120 per centum of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit if the collateral is composed of other debt instruments, including receivables; or

(D) 130 per centum of the amount of such loan or extension of credit, guarantee, acceptance, or letter of credit if the collateral is composed of stock, leases, or other real or personal property.

(d) Exemptions

The provisions of this section, except subsection (a)(4) of this section, shall not be applicable to—

(1) any transaction, subject to the prohibition contained in subsection (a)(3) of this section, with a bank—

(A) which controls 80 per centum or more of the voting shares of the member bank;

(B) in which the member bank controls 80 per centum or more of the voting shares; or

(C) in which 80 per centum or more of the voting shares are controlled by the company that controls 80 per centum or more of the voting shares of the member bank;

(2) making deposits in an affiliated bank or affiliated foreign bank in the ordinary course of

correspondent business, subject to any restrictions that the Board may prescribe by regulation or order;

(3) giving immediate credit to an affiliate for uncollected items received in the ordinary course of business;

(4) making a loan or extension of credit to, or issuing a guarantee, acceptance, or letter of credit on behalf of, an affiliate that is fully secured by—

(A) obligations of the United States or its agencies;

(B) obligations fully guaranteed by the United States or its agencies as to principal and interest; or

(C) a segregated, earmarked deposit account with the member bank;

(5) purchasing securities issued by an company of the kinds described in section 1843(c)(1) of this title;

(6) purchasing assets having a readily identifiable and publicly available market quotation and purchased at that market quotation or, subject to the prohibition contained in subsection (a)(3) of this section, purchasing loans on a nonrecourse basis from affiliated banks; and

(7) purchasing from an affiliate a loan or extension of credit that was originated by the member bank and sold to the affiliate subject to a repurchase agreement or with recourse.

(e) Rulemaking and additional exemptions

(1) The Board may issue such further regulations and orders, including definitions consistent with this section, as may be necessary to

administer and carry out the purposes of this section and to prevent evasions thereof.

(2) The Board may, at its discretion, by regulation or order exempt transactions or relationships from the requirements of this section if it finds such exemptions to be in the public interest and consistent with the purposes of this section.

Title 12, Code of Federal Regulations, Part 225, provides in pertinent part:

Subpart A—General Provisions

§ 225.1 Authority, purpose, and scope.

(a) *Authority.* This part (Regulation Y) is issued by the Board of Governors of the Federal Reserve System ("Board") under section 5(b) of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1844(b)) ("BHC Act"); sections 8 and 13(a) of the International Banking Act of 1978 (12 U.S.C. 3106 and 3108); section 7(j)(13) of the Federal Deposit Insurance Act, as amended by the Change in Bank Control Act of 1978 (12 U.S.C. 1817(j)(13) ("Bank Control Act"); section 8(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818 (b)); and the International Lending Supervision Act of 1983 (Pub. L. 98-181, Title IX). The BHC codified at 12 U.S.C. 1841, *et seq.*

(b) *Purpose.* The principal purposes of this part are to regulate the acquisition of control of banks by companies and individuals, to define and regulate the nonbanking activities in which bank holding companies and foreign banking organizations with United States operations may engage, and to set forth the procedures for se-

curing approval for such transactions and activities.

(c) *Scope.* (1) Subpart A contains general provisions and definitions of terms used in this regulation.

* * * * *

§ 225.4 Corporate practices.

(a) *Banking holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner.

(2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*), the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

* * * * *

§ 225.5 Registration, reports and inspections.

(a) *Registration of bank holding companies.* Each company shall register within 180 days after becoming a bank holding company by furnishing information in the manner and form prescribed by the Board. A company that re-

ceives the Board's prior approval under Subpart B of this regulation to become a bank holding company may complete this registration requirement through submission of its first annual report to the Board as required by paragraph (b) of this section.

(b) *Reports of bank holding companies.* Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.

(c) *Examinations and inspections.* The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operations and activities. The Board will rely as far as possible on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of a bank holding company or of the branch or agency of the foreign bank.

§ 225.6 Penalties for violations.

(a) *Criminal and civil penalties.* Section 8 of the BHC Act provides criminal penalties for willful violation, and civil penalties for violation, by

any company or individual of the BHC Act or any regulation or order issued under it, or for making a false entry in any book, report, or statement of a bank holding company. Civil money penalty assessments for violations of the BHC Act shall be made in accordance with Subpart B of the Board's Rules of Practice for Hearings (12 CFR Part 263, subpart B). For any willful violation of the Bank Control Act or any regulation or order issued under it, the Board may assess a civil penalty as provided in 12 U.S.C. 1817(j)(15).

(b) *Cease and desist proceedings.* For any violation of the BHC Act, the Bank Control Act, this regulation, or any order or notice issued there under, the Board may institute a cease and desist proceeding in accordance with the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*)

Title 11, United States Code, Section 105:

Power of court.

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

(c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.

Title 11, United States Code, Section 362:

Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the

estate or to exercise control over property of the estate.

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulate power;

(6) under subsection (a) of this section of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or

other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts;

(7) under subsection (a) of this section, of the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of repurchase agreements against cash, securities or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

(9) under subsection (a) of this section, of the issuance of the debtor by a governmental unit of a notice of tax deficiency;

(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease or nonresidential real property that has terminated by the expiration of the

stated term of the lease before the commencement of or during a case under this title to obtain possession of such property; or [sic]

(11) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument;

(12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under the Ship Mortgage Act, 1920 (46 App. U.S.C. 911 *et seq.*) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under section 207 of title 1I of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 *et seq.*, respectively), or under applicable State law; or

(13) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Commerce under the Ship Mortgage Act, 1920

(46 App. U.S.C. 911 *et seq.*) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage in a vessel or a mortgage, deed of trust, or other security interest in a fishing facility held by the Secretary of Commerce under section 207 or title XI of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 *et seq.* respectively).

(c) Except as provided in subsections (d), (e), and (f) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of—

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, 13 of this title, the time a discharge is granted or denied.

(d) On request of a party in interest and after notice and a rehearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such a stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

(e) Thirty days after a request under subsection (d) of this section for relief from the stay of an act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be commenced not later than thirty days after the conclusion of such preliminary hearing.

(f) Upon request of a party in interest, the court, with or without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section.

(g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

(2) the party opposing such relief has the burden of proof on all other issues.

(h) An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

Title 28, United States Code, Section 1334:

Bankruptcy cases and proceedings.

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise. This subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

(d) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.

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[illegible]

[illegible] and

[illegible]

[illegible] MCorp,
[illegible] and MCorp Management,
Respondents.

MCorp, *et al.*,
Petitioners,
v.

[illegible] of the Federal Reserve System,
Respondents.

[illegible] Writ of Certiorari to the
[illegible] States Court of Appeals
for the Fifth Circuit

[illegible] BRIEF OF MCORP, *et al.*

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QUESTIONS PRESENTED

1. Whether the exhaustion of administrative remedies provision of the Financial Institutions Supervisory Act of 1966, 12 U.S.C. § 1818(i), divests the district court of jurisdiction to enjoin administrative enforcement proceedings by the Federal Reserve Board affecting the assets of a bank holding company which is a chapter 11 debtor in possession.

2. Whether the Federal Reserve Board has statutory authority to promulgate and enforce its "source-of-strength" assessment policy to compel a bank holding company to transfer all its available assets into its subsidiary banks.

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JOINT BRIEF OF MCORP, *et al.*

STATUTORY PROVISIONS INVOLVED

Pertinent sections of the Bankruptcy Reform Act of 1978, As Amended ("Bankruptcy Code") (11 U.S.C. §§ 105, 362; 28 U.S.C. §§ 1334(b), 1334(d)), the Bank Holding Company Act of 1956 ("BHC Act") (12 U.S.C. § 1841 *et seq.*), the International Lending Supervision Act of 1983 ("ILSA") (12 U.S.C. § 3901 *et seq.*), and the Financial Institutions Supervisory Act of 1966 ("FISA") (12 U.S.C. § 1818), as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), are set forth in an Appendix to the Board's Brief. Section 2106 of Title 28, and pertinent sections of amendments to the National Bank Act adopted in 1933, 1935, 1953 and 1959, are reprinted in an Appendix hereto.

STATEMENT OF THE CASE

This case arises out of administrative enforcement proceedings brought by the Board of Governors of the Federal Reserve System (the "Board") to determine prepetition claims against and compel payments of money by MCorp,[1] a bank holding company operating as a debtor in possession under chapter 11 of the Bankruptcy Code.

In the spring of 1988, MCorp commenced discussions with, among others, the Federal Deposit Insurance Corporation (the "FDIC"), the Comptroller of the Currency (the "Comptroller") and the Board (collectively, the "Regulators") in an effort to develop a comprehensive recapitalization and restructuring plan for MCorp and its 25 MBank national bank subsidiaries (the "MBanks"). Towards this end, on October 7, 1988, MCorp submitted a formal proposal to the FDIC which contemplated a

[1] MCorp is the parent company of both MCorp Financial Inc. and MCorp Management, both of which also are operating as debtors in possession under chapter 11. MCorp, MCorp Financial Inc. and MCorp Management have only wholly owned subsidiaries. All three companies will be referred to collectively as "MCorp."

global recapitalization and restructuring of MCorp and its subsidiaries, involving the infusion of substantial new private capital and FDIC open-bank assistance for the MBanks.

Despite MCorp's commitment to dedicate all its liquid assets to such a restructuring, the Regulators insisted that MCorp first infuse all its available assets into the MBanks as a condition precedent to opening negotiations for FDIC open-bank assistance. Such an infusion, however, unaccompanied by open-bank assistance, would have been insufficient to avert the failure of a substantial number of the weakest MBanks, and consequently it would have inured to the sole benefit of the FDIC. Several MCorp creditors both threatened and initiated legal action against MCorp and its board of directors to enjoin such a use of MCorp's assets because it would have been "obviously improper for the Board [of Directors] to allow MCorp to risk its own assets, or those of its nonbank or healthy bank subsidiaries, on stopgap measures that will only prolong the deterioration of the troubled bank subsidiaries." J.A. 166. When MCorp refused the Regulators' demands, the Regulators embarked on a carefully orchestrated scheme to strip MCorp of its assets and to seize the MBanks.[2]

1. The Source-of-Strength Proceeding and the Temporary Cease-and-Desist Orders

On October 19, 1988, the Board commenced administrative enforcement proceedings against MCorp through the issuance of a "notice of charges" which, as amended on October 26, 1988, alleged that MCorp was engaging in "unsafe and unsound banking practices" and violations of law and regulation by refusing immediately to contribute its available assets to the troubled MBanks. J.A. 56-64, 71-83. These administrative proceedings were based upon the Board's "source-of-strength" assessment policy, pursuant to which the Board claims authority to compel a bank holding company to contribute all its available funds to a subsidiary bank without regard to the bank's financial condition or viability. The Board also issued three temporary cease-and-desist orders, which, under law, were effective immediately. J.A. 65-67, 68-70, 84-86.[3] The first two temporary orders were, according to the Board, "designed to preserve [the Board's] practical ability to enforce the source-of-strength requirements" by broadly restricting any transactions that would have resulted in the "dissipation" of MCorp's assets. Board Br. (5th Cir. Aug. 14, 1989) 6; J.A. 66, 69. The third temporary cease-and-desist order demanded that MCorp immediately "take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks." J.A. 85.

[2] *See MCorp* v. *Clarke*, 755 F. Supp. 1402, 1404-05, 1414-16 (S.D. Tex. 1991).

MCorp timely challenged the Board's three temporary orders in the United States District Court for the Northern District of Texas pursuant to 12 U.S.C. § 1818(c)(2).[4] On November 7, 1988, the Board agreed temporarily to stay its source-of-strength proceedings and the third temporary cease-and-desist order—but not the first and second temporary orders—while the FDIC considered MCorp's formal recapitalization proposal. J.A. 184. Subsequently, the Northern District stayed MCorp's challenge for the duration of the preliminary injunction issued in this proceeding. *See* J.A. 50, 178-79.

2. The Seizure of the MBanks and the Filing of the Chapter 11 Cases

On March 28, 1989, two days after learning from MCorp of the filing by three small MCorp creditors of an

[3] 12 U.S.C. § 1818(c) provides that a temporary cease-and-desist order shall become effective "upon service."

[4] MCorp advised the Board that it would not downstream its assets into the undercapitalized MBanks "because such action would have constituted a waste of MCorp's assets, fraudulent conveyances of those assets, and a violation of Delaware law subjecting MCorp and its officers and directors to personal liability," unless such a downstreaming of assets were accomplished as part of a global restructuring of the MCorp enterprise. J.A. 200.

involuntary petition against MCorp for relief under chapter 7 of the Bankruptcy Code, the FDIC rejected MCorp's proposed global recapitalization. As described by the Board, "[t]he FDIC's decision set in motion a chain of events culminating in the insolvency" and seizure by the Comptroller and the FDIC of 20 of the 25 MBanks (the "Closed MBanks").[5] Board Br. (5th Cir. Aug. 14, 1989) 7-8.

On March 31, 1989, MCorp sought protection under chapter 11 of the Bankruptcy Code by converting the involuntary chapter 7 petition to a voluntary chapter 11 reorganization. MCorp continues to operate its remaining business as a debtor in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

3. The Section 23A Proceeding

Less than ten days after the involuntary bankruptcy petition was filed against MCorp and two days after the Comptroller seized the Closed MBanks, the Board issued yet a third notice of charges alleging that MCorp had violated section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, "beginning in 1987," by failing to make certain contractually required payments allegedly due to MBank Houston and MBank Dallas, two of the Closed MBanks.[6] Board Mem. of Law (S.D. Tex. May 25, 1989) at 23 n.13; *see also* J.A. 90.

The Board's section 23A proceeding seeks to compel MCorp to account for and pay to the FDIC, as receiver

[5] In two related cases, the United States District Court for the Northern District of Texas has ruled that the FDIC and the Comptroller violated the National Bank Act in closing 12 of these MBanks that were solvent when seized. *MBank New Braunfels* v. *FDIC*, 721 F. Supp. 120 (N.D. Tex. 1989); *MCorp* v. *Clarke*, 755 F. Supp. 1402 (N.D. Tex. 1991).

[6] The Board alleged that these alleged prepetition monetary obligations violated section 23A as unsecured extensions of credit. J.A. 90. However, the transaction allegedly giving rise to MCorp's monetary obligation to the Closed MBanks was itself reviewed by the Board in 1986 in advance of its implementation and not criticized. J.A. 207.

of MBank Houston and MBank Dallas, disputed *prepetition* claims arising out of transactions that occurred more than two years prior to the seizure of the Closed MBanks and the filing of MCorp's bankruptcy cases. The FDIC, as receiver for the Closed MBanks, sought to recover for the *same* alleged unsecured credit extensions that are the subject of the Board's section 23A proceeding by filing a proof of claim in MCorp's chapter 11 case. Although the district court recently dismissed as time-barred that portion of the FDIC's claim that arose prior to March 28, 1987, the remainder of the FDIC's claim will be heard and determined by the district court in accordance with section 502 of the Bankruptcy Code.

4. Reactivation of the Source-of-Strength Proceeding

On May 24, 1989, while MCorp was a chapter 11 debtor in possession subject to the oversight and protection of the bankruptcy court and Bankruptcy Code, the Board reactivated the October 1988 source-of-strength proceedings by issuing a "Second Amended Notice of Charges" seeking the issuance of a cease-and-desist order against MCorp "including a requirement that MCorp *immediately* make . . . additional investments in its Subsidiary Banks." J.A. 193 (emphasis added). The Second Amended Notice also reaffirmed the continuing effectiveness of the three outstanding temporary cease-and-desist orders, J.A. 194, which included the requirement that MCorp "use all of its assets to provide capital support to its Subsidiary Banks," J.A. 85. Thus, after MCorp's chapter 11 filing, the Board sought to compel MCorp to transfer its assets to its subsidiary MBanks, thereby attempting to deplete the assets available for distribution to MCorp's creditors.

5. Proceedings Below

On June 9, 1989, the district court, sitting in bankruptcy, issued a preliminary injunction against the Board's pending administrative enforcement proceedings and the three outstanding and effective temporary cease-and-desist orders, and further enjoined the Board from any other effort to use:

its authority over bank holding companies or banks to attempt to effect, directly or indirectly, a reorganization of the MCorp group or its components or to interfere, except through participation in the bankruptcy proceedings, with the restructuring being developed in the bankruptcy proceeding.

J.A. 54. The district court specified that the preliminary injunction left completely unaffected the Board's "general execution, supervisory, and examination duties of the operations of MCorp and its bank subsidiaries." *Id.*

On May 15, 1990, the United States Court of Appeals for the Fifth Circuit vacated the injunction with respect to proceedings on the Board's section 23A charges, ruling that the bankruptcy court could not interfere with the Board's jurisdiction to prosecute its section 23A charges against MCorp. The court of appeals also remanded the case to the district court with instructions to enjoin proceedings on the Board's source-of-strength charges because those "proceedings exceed[ed] its statutory authority." J.A. 36.

SUMMARY OF THE ARGUMENT

Section 362(a) of the Bankruptcy Code, 11 U.S.C. § 362(a), provides that the filing of a petition under the Bankruptcy Code operates as an automatic stay against, *inter alia*, any "judicial, *administrative* or other action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy] case . . . or to recover a claim against the debtor that arose before the commencement of the case," "any act to . . . exercise control over property of the estate" and "any act to collect, assess, or recover a [prepetition] claim against the debtor." (Emphasis added.) The stay takes effect automatically as a *statutory* matter. Therefore, no judicial action is necessary to invoke it. Both 12 U.S.C. § 1818(i), on which the Board relies to escape the all-encompassing jurisdiction of the bankruptcy court, and the legislative history of that section, are devoid of any language or indication of a congressional intent to

override an automatic *statutory* stay such as the one provided by section 362(a). The language in section 1818(i), relied on by the Board, addresses only *court* review of an administrative cease-and-desist order; it does not affect the operation of a statutorily mandated automatic stay.

The Board's proceedings to compel payments of money by MCorp and to assert control over MCorp's assets are not within the "governmental action" exception to the automatic stay of section 362(b)(4) of the Bankruptcy Code. The plain language of that exception makes it applicable *only* to an automatic stay arising under section 362(a)(1). That exception is inapplicable to stays arising under sections 362(a)(3) and (6), which are at issue here. Those provisions stay "any act to obtain possession of property of the [debtor's] estate . . . or to exercise control over [such] property," or to "assess, or recover a claim . . . that arose before the [bankruptcy case]."

Even as to governmental proceedings that are not automatically stayed, the Bankruptcy Code expressly establishes a procedure designed to balance the legitimate regulatory functions of governmental units with the fundamental purposes of the Bankruptcy Code. Specifically, section 105(a) of the Bankruptcy Code authorizes the bankruptcy courts to enjoin administrative enforcement proceedings excepted from the automatic stay when the proceedings threaten the assets or the reorganization of the debtor or interfere with administration of the estate by the court. Although the issuance of a section 105(a) injunction, unlike a section 362 automatic stay, requires judicial action, such action is not precluded by 12 U.S.C. § 1818(i). The Board concedes that section 1818(i) is not a "jurisdictional bar," but merely "calls for the exhaustion of administrative remedies." Board Br. 32, 35. Such an exhaustion requirement does not override the broad congressional grant of bankruptcy jurisdiction to the district courts.

Title 28, a vital part of the bankruptcy scheme, vests the district court, sitting in bankruptcy, with *exclu-*

sive jurisdiction over MCorp's property. 28 U.S.C. § 1334(d). Further, title 28 vests the district court, sitting in bankruptcy, with broad jurisdiction over all matters and proceedings relating to a bankruptcy case in order to ensure effective administration of a bankruptcy case and to prevent piecemeal litigation in multiple forums. 28 U.S.C. § 1334(b). Significantly, section 1334(b) expressly provides that the jurisdiction of another tribunal—even one with statutorily exclusive jurisdiction—does not oust the district court from exercising jurisdiction over "*all* civil proceedings" relating to a debtor's bankruptcy case.

This overriding grant of original concurrent jurisdiction invested the district court with jurisdiction to enter a preliminary injunction against the Board's administrative enforcement actions and its temporary cease-and-desist orders, "[n]otwithstanding" any allocation by section 1818 of "exclusive jurisdiction" to review the Board's administrative enforcement proceedings. There is no basis for the Board's assertion that the section 1334(b) override of jurisdictional exclusivity statutes is inapplicable to adjudicatory proceedings pending before Article I tribunals. In addition, the district court had jurisdiction under section 1334(b) to enjoin the temporary cease-and-desist orders by virtue of its concurrent jurisdiction over the pending "civil proceedings" relating to MCorp's challenge in the Northern District of Texas to the Board's temporary cease-and-desist orders pursuant to 12 U.S.C. § 1818(c)(2). *See* J.A. 177.

Jurisdiction to enjoin the Board's source-of-strength proceedings also exists on the ground that the Board has no statutory authority to levy source-of-strength assessments on bank holding companies. Neither the BHC Act, FISA, nor ILSA furnishes any basis for the purported authority of the Board to levy monetary assessments against bank holding companies. The court of appeals correctly ruled that the source-of-strength assessment policy—pursuant to which the Board claims authority to compel a bank holding company to contribute all

its available assets to a subsidiary bank—clearly exceeds the Board's statutory authority. The Board concedes that no statute expressly grants such authority. Notwithstanding this conclusive concession, the Board purports to find this authority to levy unlimited monetary assessments against bank holding companies in an internal policy derived from the Board's "construction of [three] interrelated statutory schemes." Board Pet. 14.

On many occasions over the past 58 years, Congress has considered the very authority the Board asserts here and, in each instance, refused to grant the Board the authority to compel bank holding companies to pour their funds into subsidiary banks. Indeed, in the Banking Acts of 1933 and 1935, which established the initial framework for the regulation of bank holding companies, Congress expressly prohibited bank regulators from imposing mandatory assessments on shareholders of national banks. More recently, the issue of shareholder assessment powers was again before Congress in 1987, 1988, 1989 and 1990, and is now before the current session of Congress in several pending bills. To date, however, Congress has rejected all efforts to invest the Board with shareholder assessment powers.

Indeed, both the economic wisdom and the legality of the Board's purported authority have been challenged by the FDIC, the government agency responsible for administering the deposit insurance funds. Instead, the FDIC sought and obtained for itself the statutory power to assess affiliated federally insured *banks*—but *not* bank holding companies or their nonbank subsidiaries—for the FDIC's losses in closing affiliated banks. The Board's policy arguments underlying its disagreement with the FDIC concerning the desirability of a source-of-strength assessment power, Board Br. 41, properly should be addressed, as they have been in the past, to Congress.

ARGUMENT

I. PROSECUTION OF THE BOARD'S ADMINISTRATIVE PROCEEDINGS WOULD VIOLATE THE AUTOMATIC STAY OF THE BANKRUPTCY CODE

A. The Automatic Stay Applies to All Nonexcepted Administrative Actions

Section 362(a) of the Bankruptcy Code provides that the filing of a petition under the Bankruptcy Code operates as an *automatic* stay against virtually any action, including any judicial, administrative or other proceeding, that interferes with the district court's jurisdiction over and administration of the debtor's bankruptcy case. In pertinent part, section 362(a) provides that the filing of a bankruptcy petition operates as a stay, applicable to all entities,[7] of—

> (1) the commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under [the Bankruptcy Code], or to recover a claim against the debtor that arose before the commencement of the case under [the Bankruptcy Code];
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; [and]
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under [the Bankruptcy Code.]

11 U.S.C. § 362(a).

The automatic stay is one of the fundamental protections of the Bankruptcy Code, designed to benefit creditors and other parties in interest—including governmen-

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[7] The term "entity" under the Bankruptcy Code includes departments, agencies or instrumentalities of the United States. 11 U.S.C. §§ 101(15) & (27).

tal agencies—as well as the debtor. As explained in the legislative history accompanying the Bankruptcy Code:

> The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.
>
> The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977) (the "House Report"); S. Rep. No. 989, 95th Cong., 2d Sess. 49, 54-55 (1978) (the "Senate Report"). Thus, to prevent dismemberment of the estate and to ensure its orderly distribution, "[t]he scope of [the automatic stay] is broad" and applies to all proceedings, "including arbitration, license revocation, administrative, and judicial proceedings." House Report at 340. As this Court observed in *Midlantic National Bank* v. *New Jersey Department of Environmental Protection*, 474 U.S. 494, 504 (1986), "in enacting § 362 in 1978, Congress significantly broadened the scope of the automatic stay." In fact, the scope of the stay is so broad that, as this Court further observed, "it was necessary for Congress to limit this new power expressly" in those circumstances where it intended to allow the government to commence or continue judicial or administrative proceedings. *Id.* at 504.

The court of appeals, however, brushed aside the automatic stay—without even considering whether the Board's

administrative proceedings were authorized pursuant to any statutory exception—on the unprecedented ground that 12 U.S.C. § 1818(i) supersedes the automatic statutory stay. Whatever the effect of section 1818(i) on judicial action respecting Board proceedings, a stay pursuant to section 362(a) is self-executing and automatic and does not require judicial action and, therefore, does not implicate section 1818(i).

Moreover, as the Board acknowledges, section 1818(i) does not provide a "jurisdictional bar"; it merely "calls for the exhaustion of administrative remedies." Board Br. 32, 35. Therefore, even under the Board's reading of section 1818(i), the Bankruptcy Code's automatic stay inevitably will take effect at some point in time—*i.e.*, either upon the Board's entry of an immediately effective and appealable temporary cease-and-desist order (which, in fact, has already occurred here) or at the conclusion of the administrative proceedings and the entry of a final Board order. Such an absurd off-again-on-again application of the section 362(a) stay is contrary to the strong congressional policy underlying that fundamental protective provision. Neither law nor logic supports the court of appeals' conclusion that a statutory provision establishing the procedure for judicial review of certain administrative enforcement proceedings overrides the automatic bankruptcy stay that applies—without any court action—to all administrative and judicial proceedings except those statutorily excepted.[8]

[8] The court of appeals' reliance on decisions holding "that the automatic stay provisions of the Bankruptcy Code . . . do not supersede the anti-injunction provision of the Norris-La Guardia Act," J.A. 21, is misplaced because, unlike section 1818(i), the Norris-La Guardia Act effects a broad, overriding congressional policy to withdraw from *all* federal courts *all* jurisdiction to issue injunctions in labor disputes. *See Order of R.R. Telegraphers* v. *Chicago & Northwestern Ry.*, 362 U.S. 330, 335-36 (1960). Further, the Norris-La Guardia Act anti-injunction provision was intended to protect the substantive rights of private parties and, indeed, none of the Board's cited cases even involved administrative agency action.

B. The Governmental Action Exception Does Not Apply to Acts To Obtain Possession of or Exercise Control Over a Debtor's Property or To Collect or Assess a Claim

To avoid the operation of the automatic stay, the Board relies on the narrow exception to the automatic stay for certain actions by governmental units in furtherance of their "police or regulatory power." [9] Specifically, section 362(b)(4) of the Bankruptcy Code provides that the filing of a bankruptcy case does not operate as an automatic stay:

> *under subsection (a)(1)* of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power.

11 U.S.C. § 362(b)(4) (emphasis added). The governmental action exception to the automatic stay was "intended to be given a *narrow construction* in order to permit governmental units to pursue actions to protect the public health and safety." [10]

As is plain on its face, this exception applies *only* to a stay under section 362(a)(1) of the Bankruptcy Code. *No* exception applies to actions stayed under section 362(a)(3) or (6), and courts consistently have held that the "governmental action" exception to the automatic

[9] In section 362(b), Congress also enumerated several specific exceptions to the automatic stay for certain actions by administrative agencies. Significantly, none of those specific exceptions applies to the Board's administrative proceedings.

[10] 124 Cong. Rec. S17,406 (daily ed. Oct. 6, 1978) (statement of Senator DeConcini), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6505, 6513 (emphasis added); 124 Cong. Rec. H11,089 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6436, 6444-45 (emphasis supplied). Contrary to the Board's assertion that courts have consistently given the governmental action exception a broad interpretation (Board Br. 23-24), consistent with congressional intent, courts have limited the excepted actions to those "affecting health, welfare, morals and safety."

stay does not apply when the governmental unit is attempting to obtain or control property of the debtor's estate.[11] As this Court stated in *Ohio* v. *Kovacs*, "[t]he automatic stay provision does not apply to suits to enforce the regulatory statutes of the State, but the enforcement of such a judgment *by seeking money from the bankrupt . . . is another matter*." 469 U.S. 274, 283-84 n.11 (1985) (emphasis added).[12]

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[11] *See In re Cash Currency Exchange, Inc.*, 762 F.2d 542, 555-56 (7th Cir. 1984); *Missouri* v. *United States Bankruptcy Court*, 647 F.2d 768, 776 (8th Cir. 1981), *cert. denied*, 454 U.S. 1162 (1982); *see also SEC* v. *First Financial Group*, 645 F.2d 429, 437 (5th Cir. 1981) ("Significantly, there is no exemption from the automatic stay affecting an act to obtain possession of property of the estate or of property from the estate (§ 362(a)(3)).").

In circumstances similar to those here, a bankruptcy court recently held that section 362(a)(3) stayed a temporary cease-and-desist order and administrative cease-and-desist proceedings pursuant to which the Office of Thrift Supervision ("OTS") "attempt[ed] to satisfy its monetary claim from assets of the estate" of a savings and loan holding company operating under chapter 11 of the Bankruptcy Code. *Firstcorp, Inc.* v. *OTS*, 122 Bankr. 484, 490 (Bankr. E.D.N.C. 1990). The court held:

> The provisions of the temporary cease and desist order which direct Firstcorp to cancel the capital note, to transfer the stock of First Federal of Durham to First Federal of Raleigh, and to fulfill First Federal of Raleigh's capital requirements involve the transfer of assets of the estate and are therefore stayed by § 362(a)(3) and may not be enforced by OTS against Firstcorp or against Firstcorp's officers and employees.

Id.

[12] That the governmental action exception is inapplicable to the Board's self-enforcing cease-and-desist orders (*see infra* pp. 21-22) compelling the transfer of assets by MCorp is further confirmed by section 362(b)(5), which prohibits a governmental unit from enforcing a money judgment. As the Third Circuit ruled in *Brock* v. *Morysville Body Works, Inc.*, 829 F.2d 383, 389 (3d Cir. 1987), "although the stay does not operate against actions or proceedings by governmental units 'attempting to fix damages for violation of . . . a [health and safety] law,' *id.* at 343, 1978 U.S. Code Cong. & Admin. News at 6299; *see also* S. Rep. No. 989, 95th Cong., 2d Sess. 52, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787,

The Board's administrative proceedings and temporary cease-and-desist orders fall under sections 362(a)(3) and (6) of the Bankruptcy Code, which stay actions to obtain possession of or exercise control over a debtor's property or to assess or recover a claim. The very purpose of the source-of-strength proceedings and temporary orders against MCorp is to compel the transfer of assets of MCorp's estate. The Board alleges that MCorp is engaging in unsafe and unsound banking practices and violations of law that MCorp can cure only by immediately contributing property from the bankruptcy estate to its subsidiary MBanks and to the FDIC as receiver for the Closed MBanks. J.A. 84-85, 192. *Cf. Ohio* v. *Kovacs*, 469 U.S. 274, 281 (1985) ("There is no suggestion by plaintiff that defendant can render performance under the affirmative obligation other than by the payment of money."). The Board suggests that its notices of charges seek only to determine *whether* MCorp's refusal to immediately transfer assets to its subsidiary banks constitutes an unsafe banking practice and a violation of law, Board Br. 28 and that the notices do not seek "control over the property of MCorp's estate," Board Br. 13. To the contrary, the Board already has made the determination that "failure to provide assistance to a subsidiary bank . . . *will* be viewed as an unsafe and unsound banking practice and a violation of Regulation Y," J.A. 192 (emphasis added), *see also* J.A. 78-79, and the Board is seeking control over MCorp's assets by compelling a transfer of them. Such an action is plainly at odds with section 362(a)(3).[13]

5838, it does prevent a governmental unit from enforcing a money judgment."

[13] *See Firstcorp, Inc.*, 122 Bankr. at 490 ("The administrative proceeding initiated by the Notice charges Firstcorp with unsafe and unsound practices, but essentially the complaint is that Firstcorp did not infuse capital to maintain First Federal of Raleigh's minimum capital requirement. Firstcorp may only meet that obligation by expending assets of the estate and, as previously discussed, OTS's attempts to satisfy its monetary claim from assets of the estate are stayed by § 362(a)(3).").

Similarly, as the Board concedes, the section 23A proceeding seeks to compel the Debtors to pay an alleged prepetition obligation to the FDIC, as receiver for MBank Houston and MBank Dallas. *See* Board Br. (5th Cir. Aug. 14, 1989) 31-32. The alleged violation of section 23A arises from MCorp's alleged failure to make those payments. Thus, that proceeding amounts to little more than a commercial dispute between MCorp and the FDIC concerning prepetition transactions involving two of the Closed MBanks.[14]

The Board's temporary cease-and-desist orders and administrative proceedings, by "seeking money from the bankrupt"[15] and to assess and collect a prepetition claim,[16] fall well outside the scope of the "narrow" governmental action exception of section 362(b)(4). Thus, the automatic stay is applicable to the Board's temporary cease-and-desist orders and administrative enforcement

[14] In the 23A proceeding, the Board would be acting in a quasi-judicial role and seeking to recover funds allegedly owed to the Closed MBanks for and on behalf of the FDIC, which, under these circumstances, is no different from any other creditor asserting a claim against MCorp. In this regard, the Board's administrative function is indistinguishable from that of the administrative agency in *In re Dan Hixson Chevrolet Co.*, 12 Bankr. 917 (Bankr. N.D. Tex. 1981). In that case, the Texas Motor Vehicle Commission sought to determine a dispute between an automobile manufacturer and the debtor concerning the debtor's automobile dealership franchise in an administrative proceeding. The court concluded that "where the administrative agency is acting in a quasi-judicial capacity seeking to adjudicate private rights rather than effectuate public policy as defined by regulatory law the (b)(4) exception is "inapplicable." *Id.* at 921. As in *Dan Hixson,* because the Board's administrative actions seek to affect the debtor-creditor relationship between MCorp and the FDIC, as receiver for the Closed MBanks, MCorp is entitled to the protection afforded by the automatic stay.

[15] *Ohio* v. *Kovacs*, 469 U.S. at 283 n.11.

[16] *See Firstcorp, Inc.*, 122 Bankr. at 491 (administrative cease-and-desist proceeding against savings and loan holding company operating under chapter 11 "is essentially an action to collect a monetary claim . . . and is stayed in its entirety by § 362(a)(3)").

proceedings; and because the automatic stay is self-effectuating and does not require judicial intervention, 12 U.S.C. § 1818(i) is simply inapplicable in these circumstances.

II. THE DISTRICT COURT HAS JURISDICTION UNDER SECTION 1334 TO ENJOIN THE BOARD'S ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 105(a) OF THE BANKRUPTCY CODE

As an alternative to its holding that the Board's administrative proceedings are subject to the automatic stay, the district court concluded that the preservation of MCorp's opportunity to reorganize necessitated the issuance of an injunction under section 105(a) of the Bankruptcy Code. J.A. 48-49. Section 105(a) provides that bankruptcy courts may issue any order "that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). Under section 105(a), courts routinely have enjoined governmental administrative actions that threatened the assets of the debtor's estate or impaired the debtor's ability to reorganize, even though those proceedings might have been excepted from the automatic stay.[17] Indeed, in enacting the Bankruptcy Code, Congress *specifically* contemplated that courts may enjoin actions that are excepted from the automatic stay:

> Subsection (b) lists seven exceptions to the automatic stay. *The effect of an exception is not to make the action immune from injunction.*
>
> * * * *
>
> *By excepting an act or action from the automatic stay, the bill simply requires that the trustee move*

[17] *See, e.g., Missouri* v. *United States Bankruptcy Court*, 647 F.2d 768, 776 (8th Cir. 1981); *In re Shippers Interstate Serv., Inc.*, 618 F.2d 9, 13 (7th Cir. 1980); *see also SEC* v. *First Fin. Group*, 645 F.2d 429, 440 (5th Cir. 1981) ("To the extent that the exercise of [another court's concurrent] jurisdiction threatens the assets of the debtor's estate, the bankruptcy court may issue a stay of those proceedings.").

> *the court into action, rather than requiring the stayed party to request relief from the stay.* There are some actions, enumerated in the exceptions, that generally should not be stayed automatically upon the commencement of the case, for reasons of either policy or practicality. Thus, *the court will have to determine on a case-by-case basis whether a particular action which may be harming the estate should be stayed.*

Senate Report at 51 (emphasis added).[18]

In light of this unmistakable congressional intent, the use of section 105(a) to enjoin the Board's administrative proceedings is hardly the exercise of "a roving commission to do equity." Board Br. 25. It is clear that—even if the governmental action exception to the automatic stay were applicable here, which it is not—it is the district court and not the Board that should resolve any jurisdictional conflict raised by MCorp's chapter 11 filings and the Board's administrative proceedings. In claiming for itself the authority to determine which administrative actions may be brought without regard to the jurisdiction of the bankruptcy court, the Board is attempting to usurp the congressionally mandated function of the district court to resolve the potentially competing interests of debtors and the Board. The resolution of such issues by the district court, which is invested with broad jurisdiction over all matters related to the bankruptcy case, serves an important public purpose in that administrative agencies, such as the Board, may have parochial interests in conflict with those of other parties in interest in the bankruptcy case.

The interpretation of section 1818(i) urged by the Board would unnecessarily bring the Bankruptcy Code and the banking laws into direct and irreconcilable con-

[18] *In re Wedgewood Realty Group, Ltd.*, 878 F.2d 693, 701 (3d Cir. 1989) ("Congress clearly envisioned that section 105(a) would be available to issue an injunction on a case-by-case basis in situations expressly excepted from the automatic stay . . . .").

flict. This interpretation would effectively exempt from the Bankruptcy Code a whole range of administrative proceedings despite Congress' clear intent to empower bankruptcy courts to enjoin administrative proceedings by vesting them with the necessary jurisdiction. Congress has determined that any potential conflicts between the bankruptcy laws and a regulatory scheme are to be reconciled by the bankruptcy court on the case-by-case basis contemplated in sections 105 and 362 of the Bankruptcy Code.

A. The Exclusive Jurisdiction of the District Court Over MCorp's Property Divested the Board of Authority To Bring Administrative Enforcement Proceedings Seeking Control Over MCorp's Assets

In 28 U.S.C. § 1334, Congress evinced a clear intent that matters committed by another act of Congress to the *exclusive jurisdiction* of another tribunal may be heard by the bankruptcy courts if they entail control over the debtor's assets or affect the administration of the bankruptcy estate. *A fortiori*, the broad grant of bankruptcy jurisdiction to the district courts is not overridden by an exhaustion of remedies provision such as section 1818(i). *See* Board Br. 32, 35. Section 1334 grants the district court, sitting as a bankruptcy court, *exclusive* jurisdiction "of all of the property, wherever located, of the debtor as of the commencement of [the] case, and of property of the estate." 28 U.S.C. § 1334(d). As this Court explained in a case decided under the former Bankruptcy Act, the "jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of creditors." *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U.S. 734, 739 (1931). In furtherance of these objectives, the Court held that "[w]hen [the bankruptcy court's exclusive] jurisdiction has attached the court's possession cannot be affected by actions brought in other courts." *Id.* at 737 (citations omitted). As the Court noted:

> This is but an application of the well recognized rule that when a court of competent jurisdiction

> takes possession of property through its officers, *this withdraws the property from the jurisdiction of all other courts which, though of concurrent jurisdiction, may not disturb that possession.*

Id. at 737-38. (Emphasis added.) Consistent with *Isaacs*, courts have held that section 1334(d) *divests* other courts of jurisdiction previously acquired over the debtor's property.[19]

In accordance with section 1334(d) and *Isaacs*, the filing of MCorp's petition divested the Board of the jurisdiction to continue to prosecute its administrative proceedings or to initiate any new proceedings to force MCorp to downstream assets to the MBanks or the receivership estates of the Closed MBanks. Such proceedings constitute a blatant attempt to control MCorp's assets and interfere with the district court's exclusive jurisdiction over estate assets. It would be incongruous to interpret section 1334 as vesting the bankruptcy court with jurisdiction, while simultaneously interpreting the exhaustion provisions of section 1818(i) as divesting the bankruptcy court's jurisdiction in favor of an administrative agency, particularly in light of the Board's apparent concession that the bankruptcy court would regain jurisdiction immediately upon the conclusion of the administrative proceeding. Board Br. 20.

In effect conceding the district court's exclusive jurisdiction over MCorp's property, the Board attempts to sidestep that jurisdiction by recharacterizing its proceedings as seeking only "to ascertain whether MCorp has violated the law or committed unsafe or unsound banking practices" and as having only "speculative" "tangential effects" on the district court's exclusive jurisdiction. Board Br. 27-28. Such assertions are, however, wholly illusory. It is plain from the face of the temporary cease-

[19] *See In re Modern Boats, Inc.*, 775 F.2d 619 (5th Cir. 1985); *In re Louisiana Ship Management, Inc.*, 761 F.2d 1025 (5th Cir. 1985).

and-desist orders and the notices of charges that the Board seeks to compel the payment of money by MCorp. Indeed, contrary to the Board's assertion concerning the purported "absence of legally binding agency action," Board Br. 18, the outstanding temporary cease-and-desist orders exercised immediately effective control[20] over the assets of the bankruptcy estate by barring or limiting MCorp's use of its own funds, J.A. 66, 69, and by mandating the payment of money by MCorp, J.A. 85, 192-93. Similarly, the pending administrative proceedings seek to compel MCorp to cease and desist immediately from its alleged violation of section 23A (allegedly obtaining an unsecured extension of credit by failing to make contractually required payments to the two Closed MBanks) and the Board's "source-of-strength" policy. J.A. 89-91. To "cease and desist" from these alleged violations, MCorp would have to repay the alleged extension of credit and make the demanded capital infusions by disbursing its assets as directed by the Board.

Significantly, however, failure to comply immediately with a temporary or permanent cease-and-desist order subjects the respondent to substantial daily accruing civil money penalties. 12 U.S.C. § 1818(i)(2). Congress intended such penalties as a strong deterrent to noncompliance and to give temporary and permanent cease-and-desist orders "a self-enforcing effect."[21] Indeed, in

[20] Temporary cease-and desist orders remain in force until the issuance and effectiveness of a permanent cease-and-desist order or the dismissal of the notice of charges. 12 U.S.C. § 1818(c)(1).

[21] *Financial Institutions Supervisory Act Amendments of 1977: Report of the Senate Comm. on Banking, Housing and Urban Affairs*, S. Rep. No. 323, 95th Cong., 1st Sess. 9 (1977); *accord The Safe Banking Act of 1977: Hearings Before House Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the Comm. on Banking, Finance and Urban Affairs*, 95th Cong., 1st Sess. 2863 (1977) (statement of Robert F. Keller, Deputy Comptroller General); *Abercrombie* v. *Clarke*, 920 F.2d 1351, 1359 (7th Cir. 1990), *petition for cert. filed*, 59 U.S.L.W. 3743 (U.S. Apr. 22, 1991) (No. 90-1626) (*Cease-and-desist orders "are meant to have a 'self-enforcing' effect on the banking community. . . .* The banker under a cease and desist order operates with the knowledge

authorizing the use of these massive sanctions, Congress intended to eliminate the need to prosecute a separate federal district court enforcement action to secure immediate compliance with an outstanding temporary or permanent cease-and-desist order.[22] This Court previously has noted the "self-enforcing" nature of administrative orders that are—like the Board's cease-and-desist orders—subject to the assessment of civil penalties from the date of effectiveness.[23]

B. 28 U.S.C. § 1334(b) Brings All Bankruptcy-Related Matters Within the Jurisdiction of the District Court and Is Not Displaced by 12 U.S.C. § 1818(i)

In addition to granting exclusive jurisdiction over a debtor's property, section 1334 grants the district court, sitting as a bankruptcy court, original jurisdiction of *all proceedings* "arising in or related to cases under [the Bankruptcy Code], . . . [*n*]*otwithstanding any Act of Congress that confers exclusive jurisdiction on* [*any*

that *any deviation from that order*—purposeful or otherwise—*will result in a significant penalty*—whether the authorities discover the violation immediately or later.") (emphasis added).

[22] *See Bank Supervision, Bank Directors, and Conflicts of Interest, Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 95th Cong., 1st Sess. 38-39 (1977) (statement of Stephen S. Gardner, Vice-Chairman, Federal Reserve Board); 104-05 (statement of Daniel J. Goldberg, Acting General Counsel, Federal Home Loan Bank Board) ("Under the present statutory scheme, an association subject to such an order "gets two bites at the apple" before it may be required to comply with the order. . . . Agency authority to impose a meaningful civil penalty for violation of the final orders . . . would *eliminate Federal court action on matters which could more appropriately and effectively be handled at the administrative level.*") (emphasis added).

[23] *ICC* v. *Atlantic Coast Line R.R.*, 383 U.S. 576, 592 (1966). In addition, willful failure to comply with a cease-and-desist order issued under the BHC Act—such as the orders at issue here—could subject the holding company and its officers and directors to criminal sanctions. 12 U.S.C. § 1847. Moreover, failure to comply with a cease-and-desist order could subject the officers and directors of a bank holding company to immediate removal. 12 U.S.C. § 1818(e).

other] *court.*" 28 U.S.C. § 1334(b) (emphasis added).[24] The legislative history explains that this provision, which was at the heart of the sweeping changes in the jurisdiction granted to bankruptcy courts under the Bankruptcy Reform Act of 1978,[25] grants district courts "broad and complete jurisdiction over all matters and proceedings that arise in connection with bankruptcy cases" to protect a debtor from, among other things, bifurcated and duplicative litigation in multiple forums. House Report at 48-49. Thus, section 1334 is part of the comprehensive statutory scheme to protect both debtors and creditors of which sections 105 and 362 are integral parts.

Continued prosecution of the Board's administrative proceeding would frustrate the purposes underlying section 1334(b) and the Bankruptcy Code. Even if the Board's proceedings were as narrow as the Board seeks to portray them, the proceedings fundamentally involve the determination of prepetition claims against a debtor under the Bankruptcy Code. Such matters routinely are heard and finally determined by the bankruptcy courts. Indeed, the section 23A proceeding, which essentially involves a "garden variety" commercial dispute over a prepetition transaction, is the subject of a pending proceeding in the district court, sitting in bankruptcy, upon MCorp's objection to the FDIC's proof of claim. If the Board is permitted to proceed with its section 23A proceeding, MCorp will be required to litigate the issues concerning the very same transaction twice—once before the district court and a second time before the Board—with the concomitant possibility that the two tribunals may reach contradictory determinations.

[24] Significantly, 12 U.S.C. § 1818(i) does not provide for superseding any Act of Congress that also provides exclusive jurisdiction for a court.

[25] The original jurisdictional provisions added by the Bankruptcy Reform Act were codified at 28 U.S.C. § 1471 (repealed). The Bankruptcy Amendments and Federal Judgeship Act of 1984 repealed section 1471, but incorporated the relevant provisions thereof, without changes which are material hereto, in 28 U.S.C. § 1334.

Ignoring the specific language and unambiguous legislative intent under section 1334(b), the Board relies on cases construing section 1818(i) which do not involve an overriding, statutory grant of exclusive or primary jurisdiction to another tribunal.[26] Courts which have confronted the issue here—the interplay between bankruptcy court jurisdiction and other federal statutes conferring exclusive jurisdiction on another tribunal—have consistently held that the phrase "[n]otwithstanding any Act of Congress that confers exclusive jurisdiction on [any other] court" is expressly intended to confer on the bankruptcy courts jurisdiction over all matters related to the debtor's chapter 11 case.[27]

Accordingly, the Board's reliance on section 1818(i) to divest the district court of jurisdiction to enjoin the Board's proceedings pursuant to section 105(a) is misplaced. Congress clearly has provided that statutes, such as section 1818, which according to the Board, vests the courts of appeals with "exclusive jurisdiction" to review the Board's cease-and-desist orders, Board Br. 32, do not bar the bankruptcy courts from exercising jurisdiction over proceedings related to a bankruptcy case. Indeed, the Board concedes that section 1334(b) "effectively superseded" jurisdictional exclusivity statutes "that otherwise would have deprived the district courts of jurisdiction." *See* Board Br. 26. To avoid the clear implication of section 1334(b), the Board argues, and the court of appeals ruled, that section 1334(b) does not apply to "civil proceedings" pending before an administrative agency or in an Article I court.

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[26] *See* Board Br. 20-21 (citing *Eastern Nat'l Bank* v. *Conover*, 786 F.2d 192 (3d Cir. 1986); *Investment Co. Inst.* v. *FDIC*, 728 F.2d 518 (D.C. Cir. 1984); *Groos Nat'l Bank* v. *Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978); *First Nat'l Bank* v. *United States*, 530 F. Supp. 162 (D.D.C. 1982)).

[27] *See, e.g., In re Casey Corp.*, 46 Bankr. 473 (S.D. Ind. 1985); *In re Shelby County Healthcare Serve. of Ala., Inc.*, 80 Bankr. 555 (Bankr. N.D. Ga. 1987).

Such a theory—that section 1334(b) may grant the bankruptcy court concurrent jurisdiction over proceedings pending before another court but not over an administrative proceeding—is faulty, illogical, and without precedent. This argument conflicts with both the plain terms of section 1334(b), which gives the district court sitting in bankruptcy jurisdiction over "all civil proceedings," including administrative proceedings, and with the purposes of the broad grant of jurisdiction conveyed on the district courts by the Bankruptcy Code. Indeed, as the court of appeals acknowledged, J.A. 19, such a theory contradicts *In re Casey Corp.* and *In re Shelby County Healthcare Services of Alabama, Inc.*,[28] the only other cases that have considered the issue.

C. Statutory Construction of Sections 1334 and 1818(i) Demonstrates That If They Are Incompatible, Section 1334 Preempts Section 1818(i)

The Board's resort to a simplistic application of hornbook rules of statutory construction to support its position that section 1818(i) divests the district court of jurisdiction is entirely without merit.[29] As the cases cited by the Board demonstrate, these rules apply only "[w]here there is no *clear* intention otherwise." *Crawford Fitting Co.* v. *J.T. Gibbons, Inc.*, 482 U.S. 437, 445 (1987) (citations omitted). In enacting section 1334, Congress has expressed its clear intent to extend the bankruptcy courts' jurisdiction to all matters "relating to" chapter 11 cases, "notwithstanding any other Act of Congress to the con-

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[28] 46 Bankr. 473 (S.D. Ind. 1985); 80 Bankr. 555 (Bankr. N.D. Ga. 1987).

[29] The Board's resort to the maxim that a "specific" statute governs a "general" statute is, under the circumstances of the instant case, patently absurd. Contrary to the Board's assertions, the provisions of section 1334 are no less narrow, precise and specific than the provisions of section 1818. *See Watt* v. *Alaska*, 451 U.S. 259, 267 (1981) (where the Court, in declining to read two statutes as being in irreconcilable conflict, stated "[w]e must read [both] statutes to give effect to each if we can do so while preserving their sense and purpose.").

trary"—a congressional mandate as specific and significant as that of section 1818(i).[30]

Finally, the tax anti-injunction provision of the Internal Revenue Code, 26 U.S.C. § 7421(a), which has been held to have been overridden by the Bankruptcy Code, makes it all the more clear that the exhaustion of administrative remedies policy underlying section 1818(i) does not supersede the broad authority of the district court in bankruptcy. In *Bostwick* v. *United States*, 521 F.2d 741 (8th Cir. 1975), the debtor filed a motion to determine whether taxes owed the federal government were discharged by the bankruptcy court's order of discharge. Thereafter, the debtors moved to enjoin the government from collecting back taxes until the bankruptcy court could determine the motion. The government argued that the tax anti-injunction statute prohibited the bankruptcy court from entertaining the injunctive action. The Eighth Circuit held that the Bankruptcy Code overrides the tax anti-injunction statute:

> However, we do not believe that the "anti-injunction statute" is relevant to the present case inasmuch as Congress has evidenced an intention to enact a complete scheme governing bankruptcy which overrides the general policy represented by the "anti-injunction" act.
>
> * * * *
>
> *We believe that the overriding policy of the Bankruptcy Act is the rehabilitation of the debtor and we are convinced that the Bankruptcy Court must have the power to enjoin the assessment and/or collection of taxes in order to protect its jurisdiction, administer the bankrupt's estate in an orderly and efficient manner, and fulfill the ultimate policy of the Bankruptcy Act.*

521 F.2d at 744 (emphasis added).[31]

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[30] Significantly, unlike section 1334, section 1818(i) reflects no similar intent to override conflicting federal statutes.

[31] The Board's reliance below on *In re Becker's Motor Transportation, Inc.*, 632 F.2d 242 (3d Cir. 1980), *cert. denied*, 450 U.S. 916 (1981), is misplaced. *See* Board Br. (5th Cir. Aug. 14, 1989) 23. Although the court in *Becker's Motor* reached a different result from *Bostwick*, it never addressed the fundamental policy issue decided in *Bostwick*—which statute should govern. Rather, the *Becker's Motor* court focused on the fact that Congress added exceptions to the tax anti-injunction statute only four months after conferring on bankruptcy courts the power to adjudicate tax claims and concluded that, in those circumstances, reading the Bankruptcy Act to override the tax anti-injunction statute would contravene congressional intent. 632 F.2d at 246. As discussed above, such statutory construction arguments do not apply to section 1818(i) and, in fact, contradict the Board's own position.

III. THE COURT BELOW HAD JURISDICTION TO RULE ON THE INVALIDITY OF THE BOARD'S SOURCE-OF-STRENGTH ASSESSMENT POLICY AS PART OF MCORP'S CHALLENGE TO THE TEMPORARY CEASE-AND-DESIST ORDERS

Regardless of whether section 1334(b) grants the district court jurisdiction to stay the Board's pending administrative actions, the court below had jurisdiction to rule on the merits of the Board's source-of-strength assessment policy by virtue of MCorp's pending challenge to the temporary cease-and-desist orders in the District Court for the Northern District of Texas. J.A. 174. The Board concedes that 12 U.S.C. § 1818(i) does not restrict the district court's "jurisdiction to issue an injunction . . . [against] a *temporary* cease-and-desist order" prior to the completion of the administrative proceedings. Board Br. 20. Indeed, such authority is expressly granted by 12 U.S.C. § 1818(c)(2). The Board also concedes that section 1334(b) grants the district court sitting in bankruptcy concurrent jurisdiction over pending cases "previously committed to the exclusive jurisdiction of another *judicial* forum" by a statute such as section 1818. *Id.* at 26.

Under section 1334(b), as the Board apparently concedes, *see* Board Br. 26, the district court, sitting in bankruptcy, can exercise its original concurrent jurisdiction over the pending civil action in the Northern District of Texas. Based upon the district court's prelim-

inary injunction enjoining the three temporary cease-and-desist orders and its power under 1334(b), the court of appeals had jurisdiction to rule on the validity of those temporary orders, including the question of the Board's statutory authority to exercise its alleged source-of-strength assessment authority in those orders.

IV. THE BOARD'S PROPOSED SOURCE-OF-STRENGTH ASSESSMENT AUTHORITY IS WHOLLY WITHOUT STATUTORY SUPPORT

In any event, because the Board has no statutory authority to bring a source-of-strength assessment proceeding, the Board cannot lawfully proceed with its source-of-strength assessment action, and the district court properly enjoined that proceeding and the related temporary cease-and-desist orders.

The Board concedes that it has no express statutory authority to assess bank holding companies for the losses of subsidiary banks, but argues that three statutes, when read together and considered as a whole, somehow impliedly grant it such authority.[32] According to the Board, nothing in these statutes "precludes the Board from determining . . . that bank holding companies, despite their legal status as separate corporate entities, must ultimately remain accountable for the capital adequacy of their subsidiary banks." Board Pet. 25.

This unprecedented statutory analysis turns the law upside down. Agency authority must be rooted in an affirmative statutory grant. *See Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361 (1986); *Wheeler* v. *Greene*, 280 U.S. 49 (1929). For an administrative agency to claim authority on the basis that statutes do not expressly preclude such authority is contrary to law and, in the circumstances here, directly contrary to congressional intent and the legislative history on the repeal of shareholder assessment authority.

[32] The BHC Act, 12 U.S.C. § 1842(c), FISA, 12 U.S.C. § 1818, and ILSA, 12 U.S.C. § 3901 *et seq.*; *see* Board Br. 18, 36.

A. Congress Banned Shareholder Assessments

Contrary to the Board's theory of congressional silence, Congress has spoken directly to the issue of shareholder assessment authority on a number of occasions. As noted by the FDIC, the Board's claimed authority to assess bank holding companies for losses of capital of subsidiary banks is inconsistent with the repeal by Congress of the shareholder assessment powers previously authorized under the National Bank Act.[33]

As originally enacted in 1864, the National Bank Act imposed double liability on shareholders of national banks.[34] In a series of four amendments to the National Bank Act, adopted in 1933, 1935, 1953 and 1959, Congress repealed these shareholder assessment provisions and completely eliminated the assessability of national bank stock.[35] These amendments embody the "manifest purpose and intention on the part of the Congress to do

[33] *See* FDIC, *Mandate for Change: Restructuring the Banking Industry* 94 (Oct. 1987). All of MCorp's current and former subsidiary banks involved in the Board's action are (or were prior to their seizure) national banks.

[34] Act of June 3, 1864, ch. 106, 13 Stat. 99 (formerly codified at 12 U.S.C. § 63). National bank shareholders were individually responsible for all "contracts, debts, and engagements" of the national bank "to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares." *See also* Federal Reserve Act, Pub. L. No. 63-43, § 23, 38 Stat. 273 (1913) (formerly codified at 12 U.S.C. § 64).

[35] 12 U.S.C. § 64a; Banking Act of 1933, Pub. L. No. 73-66, § 22, 48 Stat. 162, 187 (1933); Banking Act of 1935, Pub. L. No. 74-305, § 304, 49 Stat. 684, 708 (1935); Act of May 18, 1953, Pub. L. No. 83-28, 67 Stat. 27 (1953); Act of Sept. 8, 1959, Pub. L. No. 86-230, § 7, 73 Stat. 457 (1959). Over the same period, most of the states similarly repealed shareholder assessment provisions applicable to state-chartered banks. *Anderson* v. *Abbott*, 321 U.S. 349, 381 n.8 (1944) (Jackson, J., dissenting). Similarly, the FDI Act was amended to require the FDIC, acting as receiver, to waive shareholder assessments. 12 U.S.C. § 1821(g)(3); S. Rep. No. 1651, 75th Cong., 3d Sess. (1938); H.R. Rep. No. 1297, 75th Cong., 1st Sess. (1937); *see generally* Vincens, *On the Demise of Double Liability of Bank Shareholders*, 12 Bus. Law. 275 (1957).

away with the so-called 'stockholders' double liability' *and to ultimately abandon the same as a policy in the regulation of the banking business.*"[36] In adopting these amendments, Congress was quite aware that bank holding companies owned national banks, and yet chose not to retain or impose any statutory provisions permitting assessment of national bank shares held by holding companies.[37] The last of the four amendments prohibiting assessment of national bank stock was enacted three years after the BHC Act.[38] Notably, section 19 of the Banking Act of 1933, which contained the initial provisions for Board regulation of bank holding companies, required a holding company to establish a special fund of liquid assets to satisfy assessments on national bank stock issued prior to 1933, which remained subject to assessment, and on the stock of those state-chartered banks for which assessability had not yet been repealed.[39] Ultimately—after the enactment of legislation eliminat-

[36] *FDIC* v. *Heinrich*, 26 F. Supp. 293, 294 (D.S.D.), *aff'd*, 106 F.2d 633 (8th Cir. 1939) (emphasis added); *accord* H.R. Rep. No. 259, 83d Cong., 1st Sess. (1953), *reprinted in* 1953 U.S. Code Cong. & Admin. News 1642 ("It is the opinion of [the House banking] committee that the double liability feature on national bank stock should be once and for all terminated.").

[37] *See* Banking Act of 1933, Pub. L. No. 73-66, § 19, 48 Stat. 162 (first federal statutory provisions governing bank holding companies), § 22 (providing that shares issued after adoption of Act were not assessable); Banking Act of 1935, Pub. L. No. 74-305, § 311, 49 Stat. 684 (regulating bank holding company voting stock of its subsidiary banks), § 304 (providing that shares of national bank not assessable after publication of notice); *Anderson* v. *Abbott*, 321 U.S. at 375-79 (Jackson, J., in dissent to decision involving a pre-1933 assessment of national bank shares that was passed through as an assessment on shareholders of the bank's holding company, noted that Banking Act of 1933 both repealed assessability of national bank stock and provided for regulation of bank holding companies, but did not retain or create special assessment provisions applicable to bank holding companies).

[38] Act of Sept. 8, 1959, Pub. L. No. 86-230, § 7, 73 Stat. 457.

[39] Banking Act of 1933, Pub. L. No. 73-66, § 19(b)-(c), 48 Stat. 162 (formerly codified at 12 U.S.C. § 61).

ing all shareholder assessments—this liquid asset fund requirement was repealed as obsolete by the Bank Holding Company Act Amendments of 1966.[40]

Congress was keenly aware that, by eliminating the assessability of national bank stock, it was permitting shareholders to choose not to support a troubled bank.[41] Congress also was aware of the safety and soundness factor raised by eliminating stock assessability.[42] Congress, however, chose to address the safety and soundness issue by other means, such as by increasing the amount of surplus capital required to be retained by national banks.[43]

[40] Bank Holding Company Act Amendments of 1966, Pub. L. No. 485, § 13(c), 80 Stat. 242; S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). The same Congress that repealed this requirement as obsolete enacted FISA, one of the principal purported statutory underpinnings of the Board's source-of-strength assessment policy.

[41] The Board argues that the repeal of shareholder assessments "[d]oes [n]ot [u]ndermine" the Board's source-of-strength regulation because such shareholder assessments, "in stark contrast" to source-of-strength assessments, were not intended to serve the remedial purpose of preventing bank failures, Board Br. 44-45. The fallacy of this argument is demonstrated by Comptroller O'Connor's 1935 testimony concerning the remedial purpose of shareholder assessments:

> Now, let me make that very particular: Here is a bank that has an impairment of its capital, and the Comptroller says, "You have got to repair that capital and put up $100,000, or $1,000,000", and if there is no double liability, those directors and shareholders are not as interested in repairing that capital and working out the problems of that bank as if there was no double liability, because they are just apt to say, "Take it; its yours", and walk out of the picture.

Banking Act of 1935: Hearings Before House Comm. on Banking and Currency on H.R. 5357, 74th Cong., 1st Sess. 153 (testimony of Comptroller of the Currency O'Connor) ("1935 Hearings").

[42] "We must at once appreciate the fact that, by eliminating double liability on all national banks, we have tremendously weakened the banking structure of the nation." 1935 Hearings at 147 (testimony of Comptroller of the Currency O'Connor).

[43] Banking Act of 1935, §§ 309, 315 (codified at 12 U.S.C. §§ 51, 60).

These amendments to the National Bank Act were motivated in large part by the determination of Congress that the *total elimination* of monetary assessments against national bank shareholders was necessary to attract new capital to rebuild the banking system.[44] Consistent with this history, the FDIC has stated:

> [T]he "source-of-strength" doctrine does raise several questions. If this type of authority were asserted and proved to be enforceable, it would make investment in bank equities relatively unattractive: if the downside potential of an investment exceeds the initial commitment, investors will demand a higher expected return to compensate for the additional risk. It should be remembered that many bank stocks prior to the mid-1930s were subject to additional assessments if the bank experienced financial difficulties. This requirement was removed because of its negative effect on the ability of banks to raise new capital.[45]

As recently as September 25, 1990, Chairman Seidman of the FDIC testified before the House Banking Committee that "[t]he FDIC has concerns about expanding the cross-guarantee concept to require the nonbanking entities within an organization to support the organization's bank or banks." Chairman Seidman disputed the need for treating all units within a holding company as if they were parts of a "single corporate entity" and reiterated his agency's view that the implementation of a source-of-strength assessment power "would reduce market efficiency, restrain the ability of banks to be viable competitors in the financial marketplace, and limit the ability to obtain new capital for the banking industry." [46]

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[44] 1935 Hearings at 153 (testimony of Comptroller O'Connor).

[45] FDIC, *Mandate for Change: Restructuring the Banking Industry* 94 (Oct. 1987).

[46] *Deposit Insurance Reform: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 275, 324-25 (1990) (testimony of FDIC Chairman L. William Seidman,

The Board's arrogation of unlimited authority to levy monetary assessments on corporate shareholders of banks not only is inconsistent with the legal and policy position of the FDIC, but more fundamentally it is in direct contravention of the congressional repeal of shareholder assessment authority.

B. Congress Has Considered and Rejected Proposals To Reinstate Shareholder Assessment Authority

On numerous recent occasions, Congress has considered various reformulations of the repealed bank shareholder assessment provisions, and it has consistently refused to enact any legislation that would provide the Board with source-of-strength assessment authority.

In 1987, Congress considered, but did not enact, legislation suggested by a House Committee Report that would have "implement[ed]" the Board's source-of-strength assessment policy by creating a new liability rule that would have made "the holding company, in effect, commit all its resources to back the deposits of each bank or thrift subsidiary." [47] Congress similarly considered, but did not enact, a more limited source-of-strength assessment authority contained in a bill introduced by Congressman Barnard in 1987 that would have granted the federal banking regulators power to order a holding company to choose between adding capital to an inadequately capitalized subsidiary bank or divesting that bank.[48]

Again, in 1988, Congress declined to grant the Board even a limited source-of-strength assessment power. That year, Senators Garn and Proxmire introduced S. 2715, which would have amended section 5 of the BHC Act to

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citing FDIC, *Mandate for Change: Restructuring the Banking Industry*).

[47] *Modernization of the Financial Services Industry: A Plan for Capital Mobility Within a Framework of Safe and Sound Banking*, H.R. Rep. No. 324, 100th Cong., 1st Sess. 48, 79-80 (1987).

[48] H.R. 3799, 100th Cong., 1st Sess., § 101(d), 133 Cong. Rec. H11,865 (daily ed. Dec. 18, 1987).

authorize the Board, at the request of the FDIC, to require a bank holding company and its nonbank subsidiaries to contribute or transfer to any failing bank within the holding company system "such assets or services as are customarily utilized by a bank in the conduct of its business or operations." [49] Board Chairman Greenspan acknowledged that the bill would "*establish*[] the principle that the financial strength of healthy segments of the system be used to bolster the capital or financial resources of a distressed banking affiliate" and suggested that the hearing on the bill "*could explore whether* provisions should be made to require the *nonbanking assets of the holding company* to be used to support an ailing bank affiliate." [50]

In enacting FIRREA in 1989, Congress again considered proposals advanced by the federal bank regulatory agencies on how to treat problem banks within a multibank holding company system. These proposals included the Board's *proposed* source-of-strength assessment authority, and the FDIC's alternative "cross-guaranty" proposal that all subsidiary banks within a holding company system (but not the holding company itself or its nonbank affiliates) should be subject to assessment for any loss incurred by the FDIC in disposing of any failed bank within the system. The proposals were summarized in a comprehensive FDIC report on the banking system [51] that the FDIC presented to each member of the House and Senate banking committees,[52] and that shaped con-

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[49] S. 2715, 100th Cong., 2d Sess., § 2, 134 Cong. Rec. S11,441 (daily ed. Aug. 10, 1988).

[50] *Oversight on the Condition of the Financial Services Industry: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 100th Cong., 2d Sess. 488 (1988) (letter from Alan Greenspan, Chairman of Federal Reserve Board, to Sen. William Proxmire (June 29, 1988) (emphasis added)).

[51] FDIC, *Deposit Insurance for the Nineties, Meeting the Challenge* (Draft 1989) [hereinafter "FDIC 1989 Report to Congress"].

[52] *See Financial Condition of the Federal Savings and Loan Insurance Corporation and Federal Deposit Insurance Corporation at*

gressional debate on FIRREA.[53]

The FDIC urged Congress that its "cross-guaranty" proposal was "the best alternative" for dealing with the issues raised by "problem banks" within a holding company system and that the Board's "source-of-strength" proposal had "*significant drawbacks compared to the other alternatives.*" [54] The FDIC emphasized that a source-of-strength assessment policy, which would "represent[] a *significant expansion* of bank regulatory authority," [55] would impair the competitiveness of banks in the financial services industry and would discourage new investment in the banking sector. According to the FDIC, "[c]ross-bank guarantees also are preferable to source-of-strength because they better preserve the distinction between separate corporate entities within a holding company." [56]

Year End 1988: Hearings Before the House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess. 212 (1989) (statement of L. William Seidman, Chairman, FDIC); *Financial Institutions Reform, Recovery and Enforcement Act of 1989 (H.R. 1278): Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 1st Sess. 147 (1989) ("House FIRREA Hearings").

[53] While Congress was considering FIRREA, Congressman Barnard introduced a bill similar to his proposed 1987 legislation, that included a limited source-of-strength assessment power, under which a holding company would have had to choose between agreeing to add capital to an inadequately capitalized subsidiary bank or divesting control of that bank. H.R. 1992, 101st Cong., 1st Sess. § 101(d), 135 Cong. Rec. H1232 (daily ed. Apr. 13, 1989).

[54] FDIC 1989 Report to Congress at 233 (emphasis added).

[55] FDIC 1989 Report to Congress at 229, 231 (emphasis added).

[56] *Id.* at 231. The FDIC maintained that by obliterating "the distinctions between the separate corporate entities within a holding company system," and placing a bank holding company's nonbank as well as bank assets at risk when a bank subsidiary fails, the Board's "source-of-strength" proposal would impede bank holding company expansion into nonbanking areas, inhibit nonbanking firm

Congress agreed with and adopted the FDIC's cross-guaranty proposal, which is now codified in section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e). Congress did not, however, enact the Barnard bill or the Board's source-of-strength proposal or any other provision granting source-of-strength assessment authority to the Board.[57]

Congress again had the source-of-strength assessment issue before it in considering the Crime Control Act of 1990, Pub. L. No. 101-647 (Nov. 29, 1990). On May 17, 1990, two days after the court of appeals decided the *MCorp* case, the Senate Banking Committee heard testimony on the Board's source-of-strength assessment policy and the *MCorp* decision, as well as the practice of the OTS of obtaining net worth maintenance agreements from holding companies as a condition of their acquisition of a savings and loan association.[58] As adopted, Title XXVII

entry into the banking industry, reduce market efficiency, and lead to unwarranted expansion of regulatory authority. *Id.* at 229-30.

[57] The General Accounting Office has noted that section 206(e) of FIRREA "holds affiliated insured depository institutions liable for each other's losses *but does not extend this liability to holding companies unless they themselves are depository institutions.*" General Accounting Office, *Bank Powers: Report to the Chairman, Subcomm. on General Oversight and Investigations, House Comm. on Banking, Finance and Urban Affairs* at 13 n.7 (Mar. 1990) (emphasis added).

[58] *Deposit Insurance Reform and Financial Modernization: Hearings Before Senate Comm. on Banking, Housing, and Urban Affairs,* No. 973, Vol. II, 101st Cong., 2d Sess. 236-45 (May 17, 1990) (statement of Lawrence Connell), *quoted in* 136 Cong. Rec. S13,825 (daily ed. Sept. 25, 1990).

The court of appeals in *MCorp* expressly noted this practice and suggested that the Board, therefore, was not without an adequate alternative to its invalid source-of-strength assessment policy. The court observed that, "[a]s a condition to approving an application, the Board could possibly require the holding company to agree to maintain the subsidiary banks to some degree of financial soundness." J.A. 31-32 n.5. Although the Board complains that this statement offers it "little solace," Board Br. 42 n.25, the fact is that the Board has long recognized and used its application "condition-

of the Crime Control Act[59] notably failed to grant the Board or the FDIC authority to make involuntary source-of-strength assessments against holding companies.[60]

The question of a source-of-strength assessment authority is again before Congress in at least four pending bills:

(1) Section 101(d) of H.R. 192, introduced by Congressman Barnard on January 3, 1991, would grant the federal banking agencies authority to require a holding company to "contribute to the surplus capital of the insured depository institution, an amount necessary to bring the insured depository institution into compliance with the applicable minimum required capital adequacy."

(2) Title VI of H.R. 6, entitled "Source of Strength," introduced on January 3, 1991 by House Banking Committee Chairman Gonzalez, would vest the FDIC with source-of-strength assessment authority by expanding the cross-guaranty provisions of the Federal Deposit Insurance Act to assess bank holding companies and their non-

ing" authority to extract such agreements. *Board, Bank Holding Company Supervision Manual* § 204.0 (1982). The Board, however, did *not* condition the approval of the formation of MCorp on such a capital maintenance commitment, *see Mercantile Texas Corp.*, 70 Fed. Res. Bull. 595 (1984).

[59] The Crime Control Act enhances the enforceability of capital maintenance commitments (of the sort discussed in footnote 5 of the court of appeals' decision) in bankruptcy proceedings by providing, among other things, for their nondischarge in bankruptcy. Crime Control Act, § 2722, 104 Stat. 4789, 136 Cong. Rec. S18,323 (daily ed. Nov. 2, 1990). Significantly, Congress failed to provide for the enforceability in bankruptcy proceedings of the purported source-of-strength obligations of bank holding companies.

[60] Congress also declined to enact legislation introduced by Senate Banking Committee Chairman Riegle that would have granted the FDIC, but not the Board, a limited source-of-strength assessment authority by extending the FDIC's cross-guaranty assessment power to reach the assets of a holding company and other nonbank affiliates of a bank up to a maximum of five percent of the bank's assets. S. 3103, 100th Cong., 2d Sess. § 10, 136 Cong. Rec. S13,831 (daily ed. Sept. 25, 1990).

bank subsidiaries for losses incurred by the FDIC in the insolvency of an affiliated bank. Significantly, the bill would not vest any comparable assessment authority in the Board.

(3) Chairman Riegle on March 5, 1991 introduced S. 543, which would expose a bank holding company to liability for losses incurred by the FDIC in resolving the insolvency of an affiliated bank, would limit the liability of a bank holding company to a maximum of five percent of the total assets of the insolvent insured depository institution, would operate only prospectively, and would confer no authority on the Board.

(4) The Administration also has proposed a *limited* source-of-strength assessment power in connection with its program for modernizing the financial services industry. The Administration bill[61] provides, *inter alia*, that, if the capital adequacy of an insured bank falls below certain levels, its holding company would be required to restore the capital level of the bank, divest the bank, or terminate involvement in new financial activities.

It is indisputable, therefore, that Congress has repealed shareholder assessment authority, considered and rejected various proposals for reinstating shareholder assessment authority and is even now considering whether to reinstate any form of shareholder assessment authority. This extensive legislative history completely refutes the Board's claim of assessment authority. The Board apparently hopes that this Court will be more receptive to the Board's desire for source-of-strength assessment authority than Congress has been. But the authority is that of Congress—not this Court—to give.

[61] S. 713, 102d Cong., 1st Sess., 137 Cong. Rec. S3712 (daily ed. Mar. 20, 1991); H.R. 1505, 102d Cong., 1st Sess., 137 Cong. Rec. H1912 (daily ed. Mar. 20, 1991). Notably, none of these pending legislative proposals would authorize source-of-strength assessments against bank holding companies in bankruptcy.

C. The BHC Act Provides No Source-of-Strength Assessment Authority

In the face of the express repeal of shareholder assessments and repeated congressional rejection of numerous proposals to restore shareholder assessment authority, the Board purports to invoke an implied authority from three banking statutes. None of these Acts, singly or collectively, provides shareholder assessment authority.

The Board primarily relies on section 3 of the BHC Act. Section 3 directs the Board to consider the financial and managerial resources of a company at *the time the company seeks permission to acquire a bank.*[62] That is the only authority upheld in *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978). Neither that decision nor the BHC Act, however, contains any suggestion that the Board is authorized to assess a bank holding company for the losses of its subsidiary banks.

As the court of appeals observed, "*First Lincolnwood* is narrowly written and expressly limits the Board's authority to consider financial and managerial soundness of subsidiary banks to the Board's decision to grant or deny a holding company's application." J.A. 31. The court of appeals also noted that the BHC Act does not grant the Board authority to establish or enforce capital levels for, or otherwise regulate, banks owned by a bank holding company.[63] The court of appeals correctly rejected the Board's attempt to transform and expand its narrow statutory authority—to consider the financial soundness of a bank holding company in passing upon its applica-

[62] In fact, the Board "recognize[s] that Section 1842(c), by its terms, does not empower the Board to consider the holding company's continuing compliance with the terms and conditions of the acquisition." Board Br. 43.

[63] J.A. 31. The BHC Act does not grant the Board authority to regulate the activities of subsidiary banks of a bank holding company. *See Independent Ins. Agents of Am.* v. *Board of Governors*, 890 F.2d 1275 (2d Cir. 1989), *cert. denied*, 111 S. Ct. 44 (1990).

tion to acquire a bank—into a broad authority to assess a bank holding company for the losses of its subsidiary banks, at any time, without limit and without any fault on the part of the holding company.[64]

The Board concedes that the alleged monetary assessment authority at issue here "extends the Supreme Court's holding, in . . . *First Lincolnwood Corp.*"[65] As noted by Justices Stevens' and Rehnquist's dissenting opinion, the Court in *First Lincolnwood* limited its holding concerning the Board's authority to deny applications to acquire a bank to a small subset of those applications in which the "effect" of the proposed "transaction would have been the formation of a financially unsound bank holding company."[66]

In 1984, when the Board amended its Regulation Y to provide that a "bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks,"[67] the Board made no suggestion that it created an enforceable and unlimited obligation on the part of a bank holding company to downstream all its available assets into subsidiary banks.[68] Indeed, in the 1984 Regulation Y rulemaking proceeding, the Board received no substantive comments on this reiteration of its source-of-strength "concept."[69] Board Br. 6.

[64] In response to the *First Lincolnwood* decision, Congress *narrowed* the Board's authority to consider a holding company's strength by limiting the Board's power to disapprove the formation of one-bank holding companies. Depository Institutions Deregulation and Monetary Control Act, Pub. L. No. 221, § 713, 94 Stat. 190, 96th Cong., 2d Sess. (Mar. 31, 1980) (codified at 12 U.S.C. § 1842(c)) (limiting Board's power to disapprove, based upon loan on bank stock, application to form one-bank holding company).

[65] Board Suggestion for Rehearing *En Banc* (5th Cir.) at 7.

[66] 439 U.S. at 252 n.18, 258 n.6.

[67] 12 C.F.R. § 225.4; 49 Fed. Reg. 794, 820 (1984).

[68] *See* 49 Fed. Reg. 794 (1984); 48 Fed. Reg. 23,520 (1983).

[69] 49 Fed. Reg. 800 (1984).

In February 1987, in an administrative enforcement action brought against the Hawkeye Corporation,[70] the Board for the first time asserted that it could assess a bank holding company for the losses of its subsidiary banks. In April 1987, on the eve of the scheduled administrative hearing against Hawkeye, the Board dismissed its source-of-strength charges and concurrently issued a "Policy Statement" proclaiming its new "policy" that:[71]

> [A] bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity.[72]

The Board stated in its Policy Statement that a failure to provide capital to a troubled or failing subsidiary bank would be viewed as a violation of Regulation Y and an unsafe and unsound practice and that, "[w]here necessary, the Board is prepared to take supervisory action to require such assistance."[73]

[70] *In re Hawkeye Corp.*, No. 87-003-B-HC (Notice of Charges and Hearing Before the Board of Governors of the Federal Reserve System) (Feb. 5, 1987); Keeton, *Bank Holding Companies, Cross-Bank Guarantees and Source-of-Strength*, Fed. Res. Bank of Kansas City Econ. Rev. 54, 61 (May/June 1990).

[71] *See Fed Drops Case Against Hawkeye*, Am. Banker (May 4, 1987) at 11; 52 Fed. Reg. 15,707 (Apr. 30, 1987); Keeton, *supra* note 70, at 61.

[72] 52 Fed. Reg. 15,707 (1987).

[73] *Id.* at 15,708. The Board advises this Court that its Policy Statement is one of its (plural) "'source of strength' regulations," Board Pet. at I (Question Presented #2); Board Br. at I (Question Presented #3), 29, 31, a claim that the Board did not make below. As MCorp pointed out below, the Board is relying solely on the Policy Statement and "there is no statute or Board regulation which provides [source-of-strength assessment] authority." MCorp Br. 39 (5th Cir. Sept. 13, 1989); MCorp Reply Br. 32 (S.D. Tex. May 31, 1989). Contrary to the Board's new claim, the Policy Statement was *not* adopted pursuant to the notice-and-comment procedures of section 553 of the Administrative Procedure Act as required for "substantive rules." Therefore, it is not enforceable. *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 313 (1979).

Not surprisingly, federal bank regulators other than the Board—the FDIC, the Resolution Trust Corporation (the "RTC"), and the OTS—take the position that language in the Savings and Loan Holding Company Act virtually identical to the BHC Act language relied on by the Board does *not* authorize source-of-strength assessments against savings and loan holding companies.[74] According to the FDIC, "[n]othing in the detailed regulations pertaining to savings and loan holding companies (or in any other statute or regulation) obligated a holding company to maintain the insured institution's net worth." [75] Similarly, the RTC acknowledges that:

> the absence of any statute or regulation expressly requiring savings and loan holding companies to maintain the solvency of the insured institutions under their control was precisely why the FHLBB/FSLIC used net worth maintenance agreements.[76]

The fact that the Board did not "discover" its purported source-of-strength assessment authority until 31 years after the BHC Act was adopted casts substantial doubt on the existence of any basis in the BHC Act for the alleged authority.[77]

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[74] *Compare* 12 U.S.C. § 1467a(e)(2) ("the Director [of OTS] shall take into consideration the financial and managerial resources and future prospects of the company and association involved") *with* 12 U.S.C. § 1842(c) ("the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned").

[75] Brief of Appellant FDIC at 29, *In re Conner Corp.*, No. 90-488 Civ-5-BO (E.D.N.C. Sept. 28, 1990) (footnote omitted) (copy lodged with Clerk of this Court).

[76] Brief of Appellant RTC at 22, in *Resolution Trust Corp.* v. *Savers*, No. 90-2037EA (8th Cir. Sept. 28, 1990). The enforcement staff of the OTS takes the same position. OTS Enforcement Review Committee Resolution No. 89-127 at 2, *In the Matter of Gary L. Akin, Sole Stockholder, Chairman and Former President of Texas-Banc Savings, F.S.B.* (Nov. 7, 1990). (Copies lodged with Clerk of this Court.)

[77] *Cf. BankAmerica Corp.* v. *United States*, 462 U.S. 122, 1?0 (1983).

D. ILSA Provides No Source-of-Strength Assessment Authority

The Board, citing Justice Stevens' dissenting opinion in *First Lincolnwood*, erroneously implies that ILSA granted it the power to prescribe minimum bank capital ratios "by a general rule or standard applicable to all banks." Board Br. 39 n.23. In fact, ILSA expressly withholds from the Board authority to establish and enforce capital levels for subsidiary banks of a bank holding company. While ILSA authorizes the appropriate federal bank regulatory agencies to establish minimum capital requirements for banks, that Act defines the Board as the appropriate federal banking agency *only* for "bank holding companies and any *nonbank* subsidiary thereof" (emphasis added),[78] thus denying the Board any authority over the capital of a bank.

Indeed, ILSA does not grant *any* agency authority to order a bank holding company to transfer its funds into subsidiary banks. In its 1984 rulemaking proposal implementing ILSA, the Board made no mention of any purported authority to require holding companies to contribute capital to subsidiary banks,[79] but rather acknowledged "that it serves no useful purpose to increase bank capital at the expense of its parent holding company." [80] Increasing bank capital at the expense of the holding company, however, is precisely what the Board is attempting to accomplish through prosecution of its source-of-strength assessment proceeding.

E. FISA Provides No Source-of-Strength Assessment Authority

The Board also relies on its cease-and-desist powers under FISA, 12 U.S.C. § 1818, to enjoin "unsafe and unsound" practices. However, no provisions of FISA authorize the Board to require a bank holding company

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[78] 12 U.S.C. § 3902(1)(A) (designating the Board as the "appropriate Federal banking agency" for "(A) bank holding companies and any *nonbank* subsidiary thereof" (emphasis added)).

[79] 49 Fed. Reg. 30,317 (1984).

[80] *Id.*

to downstream its own assets into a subsidiary bank, as the Board concedes. *See* Board Br. 37. In addition, "Congress never intended to give these agencies a 'blank check' authority" under the cease-and-desist provisions of section 1818.[81] Nothing in the history of the legislation on cease-and-desist authority with respect to bank holding companies remotely suggests that Congress intended to grant the Board power to assess holding companies for the losses of subsidiary banks. Instead, the legislation was adopted "to assure that financial institutions are not endangered with respect to activities engaged in by parent holding companies or for nonfinancial institution subsidiaries." [82] The Board's authority to "prevent or terminate" bank holding company activities that could cause harm to an affiliated bank, *id.*, provides no basis for the Board's claimed source-of-strength assessment authority to require a holding company to invest all its assets in its subsidiary banks. Moreover, if Congress intended the cease-and-desist provisions of section 1818 to authorize the Board or the other federal banking agencies to compel affiliates of a bank to inject capital into that bank, the enactment of section 206(e) of FIRREA, granting the FDIC express statutory authority to make "cross-guaranty" assessments against affiliated banks, would have been unnecessary because the FDIC and the Board already would have had such authority under FISA. The court of appeals correctly refused to permit the Board to use its general remedial powers to bootstrap its way into the substantive monetary assessment authority long denied it by Congress.

F. FIRREA Provides No Source-of-Strength Assessment Authority

The Board's claim of support from section 902 of FIRREA (amending 12 U.S.C. § 1818(b)) also is baseless. Section 902, which was enacted after the district court's decision, expressly relates to restitutionary-type remedies, *see* Board Br. 41, where an institution-affiliated party has acted in a "reckless manner" or "was unjustly enriched" at the expense of a financial institution. Section 902 has nothing whatsoever to do with the Board's alleged authority to make and enforce capital calls on bank holding companies, regardless of fault, for the losses of their subsidiary banks. The Board's alleged source-of-strength assessment authority is not limited to losses caused by the reckless conduct or involving the unjust enrichment necessary to invoke the restitutionary remedies of section 902. Instead, the Board's purported source-of-strength assessment authority turns solely upon the fact that a bank holding company owns a bank deficient in capital.

Notably, this Court refused to permit another federal agency to enforce bank shareholder assessments in the absence of express statutory authority, rejecting that agency's claim, similar to the Board's claim here, that it had implied authority to enforce such an assessment under its general statutory authority. *Wheeler* v. *Greene*, 280 U.S. 49 (1929). Noting that the Farm Loan Act did not expressly grant the Federal Farm Loan Board with a power to assess shareholders of joint stock land banks similar to that granted to the Comptroller over national bank shareholders, this Court stated:

> When so important a grant of power contained in the prototype is left out from the copy it is almost impossible to attribute the omission to anything but design, or to believe that it is left to very attenuated implications what the model before it so clearly expressed.

280 U.S. at 51. This Court held that the general powers of the Federal Farm Loan Board to administer the Farm Loan Act were "inadequate to supply the omission of this power" to enforce shareholder assessment liability. 280 U.S. 52.

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[81] *Larimore* v. *Comptroller of Currency*, 789 F.2d 1244, 1253 (7th Cir. 1986); *accord* S. Rep. No. 1482, 89th Cong., 2d Sess., *reprinted in* 1966 U.S. Code Cong. & Admin. News 3532, 3538.

[82] S. Rep. No. 902, 93d Cong., 2d Sess. 10 (1974).

The Board's policy arguments in favor of a source-of-strength assessment power are not a substitute for the statutory authority denied it by Congress. Like any federal administrative agency, the Board possesses only the authority that Congress grants it by statute.[83] The Board may not unilaterally expand this authority based on its own interpretation of the "broad purposes" of the statutes it administers.[84] As this Court held in *Dimension Financial Corp.*, "[i]f the Bank Holding Company Act falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts, to address." 474 U.S. at 374.

V. THE BOARD'S SOURCE-OF-STRENGTH CHARGES WERE SUBJECT TO JUDICIAL REVIEW

A. 12 U.S.C. § 1818(i) Does Not Bar Review

As demonstrated above, the Board is utterly devoid of authority to levy monetary assessments against bank holding companies on the basis of its source-of-strength Policy Statement or on any other grounds. The Board nevertheless argues that 12 U.S.C. § 1818(i) barred the court of appeals from directing the district court to enjoin the Board's lawless source-of-strength assessment proceeding.

Section 1818(i) does not shelter the Board's *ultra vires* proceeding to enforce its invalid source-of-strength assessment policy. A statute, such as section 1818(i), that prescribes a general procedure for judicial review, does not

[83] *See, e.g., Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561 (1989); *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361 (1986); *Wheeler* v. *Greene*, 280 U.S. 49 (1929); *American Bank & Trust Co.* v. *Federal Reserve Bank*, 256 U.S. 350 (1921); *Business Roundtable* v. *SEC*, 905 F.2d 406 (D.C. Cir. 1990); *Western Bancshares, Inc.* v. *Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

[84] *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. at 373-74.

bar a court's jurisdiction to enjoin an administrative proceeding that is beyond the authority of the administrative agency. *Leedom* v. *Kyne*, 358 U.S. 184, 190 (1958); *Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973). Indeed, the Fourth Circuit has ruled that the holding in *Leedom* v. *Kyne* "*requires* that a federal court ascertain whether an administrative agency is acting within its authority. . . . ." *Champion Int'l Corp.* v. *EPA*, 850 F.2d 182, 186 (4th Cir. 1988) (emphasis added); *see also Dart* v. *United States*, 848 F.2d 217, 221 (D.C. Cir. 1988) ("Judicial review is favored when an agency is charged with acting beyond its authority."). In *Manges* v. *Camp*, 474 F.2d at 99, the Fifth Circuit specifically applied the *Leedom* v. *Kyne* doctrine to section 1818(i) and stated:

> There is . . . a very strong court created exception to withdrawal statutes. This exception comes into play when there has been a clear departure from statutory authority, and thereby exposes the offending agency to review of administrative action otherwise made unreviewable by statute.

Thus the court in *Manges* held that, under the doctrine of *Leedom* v. *Kyne*, section 1818(i) was inapplicable because the order at issue exceeded the Comptroller's statutory authority.[85]

Because the Board has no statutory authority to make a source-of-strength assessment against a bank holding company, there is no substance to the Board's contention that the court of appeals was constrained to await the completition of the Board's source-of-strength proceedings and the issuance of a final assessment order against

[85] *See also Graham* v. *Caston*, 568 F.2d 1092, 1097 (5th Cir. 1978) ("[I]f an administrative official clearly departs from statutory authority, the administrative action is subject to judicial review even though a jurisdiction withdrawal statute is otherwise applicable."); *accord Mid America Bancorp.* v. *Board of Governors*, 523 F. Supp. 568, 574 (D. Minn. 1980) ("The language [of section 1818(i)] cannot be read literally, however. It must yield to an interpretation that permits a district court to enjoin Board actions that clearly exceed its statutory authority.").

MCorp before interdicting those proceedings. As the Fourth Circuit has confirmed:

> If an agency acts in clear derogation of its statutory authority, a court need not wait for the underlying proceedings to conclude to intervene, *Leedom* v. *Kyne*, 358 U.S. 184, 188 . . . (1958).

Gracey v. *Local 340 Int'l Bhd. of Elec. Workers*, 868 F.2d 671, 674 n.1 (4th Cir. 1989).

B. The Exhaustion Doctrine Is Inapplicable to Ultra Vires Proceeding

Conceding that section 1818(i) does not constitute a "jurisdictional bar," Board Br. 32, the Board invokes the doctrine of exhaustion of administrative remedies, *id.* at 35. As demonstrated by the preceding section, the Board has no statutory authority to adopt or enforce its source-of-strength assessment policy. The exhaustion doctrine is irrelevant to a proceeding beyond the authority of the agency. Moreover, requiring MCorp to exhaust its administrative remedies would advance none of the purposes served by the exhaustion doctrine. The compiling of a factual record, the proper framing of issues in dispute, permitting the agency to apply its expertise, and the efficient administration of justice are common rationales for the exhaustion requirement.[86] Such rationales do not apply here because, as the court of appeals noted, no facts are disputed, the issue is a purely legal one concerning the alleged statutory authority of the Board to levy monetary assessments against bank holding companies, the courts are expert in matters of statutory interpretation, and the prompt judicial resolution of the dispute eliminates unnecessary administrative proceedings and is in the interest of efficient judicial administration. J.A. 25-26. This Court, on a number of occasions, has ruled

[86] *McKart* v. *United States*, 395 U.S. 185, 193-201 (1969); *Consumers Union of the United States, Inc.* v. *Cost of Living Council*, 491 F.2d 1396, 1399 (Temp. Emer. Ct. App.), *cert. denied*, 416 U.S. 984 (1974).

that exhaustion is not necessary when the dispute concerns a purely legal issue.[87]

C. 28 U.S.C. § 2106 Authorized the Court of Appeals To Direct the Entry of an Injunction Against the Board's Unlawful Source-of-Strength Proceeding

The independent grant of appellate jurisdiction in 28 U.S.C. § 2106 confirms the authority of the court of appeals to direct the entry of an injunction against the Board's source-of-strength assessment proceeding. App. 2a, *infra*. Appellate courts have invoked jurisdiction under section 2106 "in the interest of judicial economy." [88] *See Grosso* v. *United States*, 390 U.S. 62, 71-72 (1968).

Had the court of appeals remanded to the Board, the inevitable consequence would have been the issuance of a source-of-strength assessment against MCorp followed by a challenge, *in the very same court of appeals*, to the legality of such a source-of-strength assessment order. This course would have produced only delay, a waste of judicial resources,[89] and unnecessary expenditure of funds of the debtor and the administrative agency.

[87] *See, e.g.*, *McKart*, 395 U.S. at 197-99; *Gardner* v. *Toilet Goods Ass'n*, 387 U.S. 167, 171 (1967); *see also Frontier Airlines, Inc.* v. *Civil Aeronautics Bd.*, 621 F.2d 369, 371 (10th Cir. 1980); *National Automatic Laundry and Cleaning Council* v. *Schultz*, 443 F.2d 689, 695 (D.C. Cir. 1971); *Shell Oil Co.* v. *Federal Energy Admin.*, 400 F. Supp. 964, 968 (S.D. Tex.), *aff'd*, 527 F.2d 1243 (Temp. Emer. Ct. App. 1975).

[88] *Government of the V.I.* v. *Smith*, 445 F.2d 1089, 1095 (3d Cir. 1971).

[89] *Grosso*, 390 U.S. at 71-72; *Levin* v. *Mississippi River Fuel Corp.*, 386 U.S. 162, 170 (1967); *In re Hronek*, 563 F.2d 296, 298 (6th Cir. 1977); *Independent Bankers Ass'n of Am.* v. *Heimann*, 613 F.2d 1164, 1167 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980).

CONCLUSION

For the reasons stated herein, the court of appeals' instructions to the district court to enjoin the Board's *ultra vires* source-of-strength assessment proceeding were lawful and should be affirmed.

The court of appeals' ruling that the district court did not have jurisdiction and authority under the Bankruptcy Code to enjoin the Board from prosecuting its administrative enforcement actions is erroneous and should be reversed.

Respectfully submitted,

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APPENDIX

STATUTORY PROVISIONS INVOLVED

Section 22 of the Banking Act of 1933, codified as amended at 12 U.S.C. § 64a:

> SEC. 22. The additional liability imposed upon shareholders in national banking associations by the provisions of section 5151 of the Revised Statutes, as amended, and section 23 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 63 and 64), shall not apply with respect to shares in any such association issued after the date of enactment of this Act.

Section 304 of the Banking Act of 1935, codified as amended at 12 U.S.C. § 64a:

> SEC. 304. Section 22 of the Banking Act of 1933, as amended, is amended by adding at the end thereof the following sentences: "Such additional liability shall cease on July 1, 1937, with respect to all shares issued by any association which shall be transacting the business of banking on July 1, 1937: *Provided*, That not less than six months prior to such date, such association shall have caused notice of such prospective termination of liability to be published in a newspaper published in the city, town, or county in which such association is located, and if no newspaper is published in such city, town, or country, then in a newspaper of general circulation therein. If the association fail to give such notice as and when above provided, a termination of such additional liability may thereafter be accomplished as of the date six month subsequent to publication, in the manner above provided."

Section 2 of the Act of May 18, 1953, codified at 12 U.S.C. § 64a.

> SEC. 2. Section 22 of the Banking Act of 1933, as amended, is hereby amended by adding at the end

thereof the following sentence: "In the case of each association which has not caused notice of such prospective termination of liability to be published prior to the effective date of this amendment, the Comptroller of the Currency shall cause such notice to be published in the manner provided in this section, and on the date six months subsequent to such publication by the Comptroller of the Currency such additional liability shall cease."

Section 7 of the Act of Sept. 8, 1959:

SEC. 7. Section 5151 of the Revised Statutes (12 U.S.C. 63) and section 23 of the Federal Reserve Act (12 U.S.C. 64) are repealed.

28 U.S.C. § 2106:

The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review, and may remand the cause and direct the entry of such appropriate judgment, decree, or order, or require such further proceedings to be had as may be just under the circumstances.

(9) (6)

Nos. 90-913 and 90-914

In the Supreme Court of the United States

OCTOBER TERM, 1991

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA, PETITIONER

v.

MCORP FINANCIAL INC., ET AL.

MCORP, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM OF THE UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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REPLY BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ARGUMENT

In our opening brief, we demonstrated that: (a) Congress, through 12 U.S.C. 1818(i), has expressly divested the courts of jurisdiction to review or interfere with the Federal Reserve Board's enforcement actions until the Board issues a *final* decision; (b) a court may not enjoin the Board's enforcement action in this case under the

principles set forth in *Leedom* v. *Kyne*, 358 U.S. 184 (1958); and (c) the Board, in any event, has statutory authority to promulgate and enforce the source of strength policy that MCorp ultimately challenges. We find it necessary to restate those central points because MCorp neither responds directly to our arguments nor defends the court of appeals' decision on its own terms. Instead, MCorp takes this Court on a circuitous journey through irrelevant provisions of bankruptcy and banking law, misstating the facts, the law, and our position along the way.

A. The Bankruptcy Code Does Not Give The Courts Jurisdiction To Restrain The Federal Reserve Board's Enforcement Proceeding

1. MCorp first argues that "prosecution of the Board's administrative proceedings would violate the automatic stay of the Bankruptcy Code." MCorp Br. 10-17. The initial difficulty with that argument is that it does not address the question at issue. As the court of appeals recognized, the pivotal issue in this case is whether the district court had authority, despite the jurisdictional limitation imposed by Section 1818(i), to enjoin ongoing Board enforcement proceedings.[1] The Bankruptcy Code's automatic stay provision, 11 U.S.C. 362, does not confer jurisdiction, and it did not grant the district court power

to act in contravention of the limitations that Congress set out in Section 1818(i).[2]

In any event, the Bankruptcy Code's automatic stay provision, by its own terms, does not prevent the Board from exercising its normal regulatory and enforcement duties with respect to MCorp, which remains in business as a debtor-in-possession. The Bankruptcy Code expressly provides that the filing of a bankruptcy petition stays the commencement or continuation of "a judicial, administrative, or other action or proceeding against the debtor," 11 U.S.C. 362(a)(1), but it does *not* stay "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power," 11 U.S.C. 362(b)(4). See Gov't Br. 23-24. Thus, MCorp remains subject to the Board's

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[1] Section 1818(i)(1) provides that "except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section." 12 U.S.C. 1818(i)(1). MCorp repeatedly contends that the Board "acknowledges" or "[c]onced[es]" that section 1818(i) does not provide a "jurisdictional bar"; it merely "calls for the exhaustion of administrative remedies." MCorp Br. 12, 19, 48 (citing Gov't Br. 32, 35). MCorp misstates our position. Section 1818(i) plainly imposes a jurisdictional limitation; we explained in our opening brief that it does not impose a *complete* jurisdictional bar to judicial review. See Gov't Br. 32. That jurisdictional limitation "*effectively* calls for the exhaustion of administrative remedies." *Id.* at 35 (emphasis added).

[2] Thus, the court of appeals found no need to address the scope of the Bankruptcy Code's automatic stay. J.A. 36 n.7. Moreover, the stay at issue in this case did not arise "automatically," without intervening judicial action. Rather, MCorp filed a complaint and motion for injunctive relief requesting that the bankruptcy court issue an order "restraining and enjoining the Board from prosecuting" its enforcement actions. J.A. 122, 138. The court's authority to grant relief, even as to enforcing an "automatic" stay, was necessarily qualified by statutory provisions, such as 18 U.S.C. 1818(i), that impose jurisdictional limitations. For example, the courts of appeals have held that the Norris-LaGuardia Act's similar jurisdictional limitation, 29 U.S.C. 101, precludes judicial enforcement of an automatic stay. *Briggs Transp. Co.* v. *International Bhd. of Teamsters*, 739 F.2d 341, 343-344 (8th Cir.), cert. denied, 469 U.S. 917 (1984); *In re Crowe & Assocs., Inc.*, 713 F.2d 211, 214-216 (6th Cir. 1983); *In re Petrusch*, 667 F.2d 297, 299-300 (2d Cir. 1981), cert. denied, 456 U.S. 974 (1982). MCorp attempts to distinguish decisions such as *Briggs* and *Crowe* on the ground that the Norris-LaGuardia Act protects substantive rights of private parties. MCorp Br. 12 n.8. As this Court has observed, however, "Congress passed the Norris-LaGuardia Act to curtail and regulate the jurisdiction of courts, not * * * to regulate the conduct of people engaged in labor disputes." *Marine Cooks* v. *Panama S.S.*, 362 U.S. 365, 372 (1960).

regulatory power to ensure the safety and soundness of MCorp's banking operations.[3]

MCorp's attempts to characterize the Board's actions as falling outside the "police or regulatory power" exception are unpersuasive. The Board's "notice of charges" plainly specified that the Board was commencing proceedings to require MCorp to comply with its statutory and regulatory obligations. See J.A. 56-64, 87-93, 186-195. Indeed, MCorp itself describes the Board's cease-and-desist proceedings as "administrative enforcement proceedings" (Br. 2, 5) and acknowledges that the Board instituted them specifically to enforce Section 23A of the Federal Reserve Act and the Board's source of strength policy (Br. 2, 5).[4] There is simply no reasonable basis for disputing that the Board's cease-and-desist proceedings are "administrative" actions, 11 U.S.C. 362(a)(1), "by a governmental unit to enforce such governmental unit's police or regulatory power," 11 U.S.C. 362(b)(4).[5]

[3] The Bankruptcy Code's legislative history confirms that Section 362(b)(4) broadly exempts a wide range of police power or regulatory actions from the automatic stay, even if those actions directly affect the disposition of the debtor's property. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 343 (1977) ("where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay").

[4] The Board's administrative proceedings in this case serve important regulatory objectives related to the protection of the safety and soundness of the nation's banking system. Section 23A of the Federal Reserve Act, 12 U.S.C. 371(c), limits self-dealing between and among bank holding company subsidiaries while the Board's source of strength policy promotes the financial stability of banking subsidiaries. The Board's administrative proceedings effectuate those regulatory objectives by curing past and preventing *future* regulatory violations. See J.A. 61-63, 89-92, 191-193.

[5] The courts of appeals have held that a variety of comparable regulatory actions that have a direct and immediate impact on the debtor's property are nonetheless exempt from the automatic stay. See, *e.g.*, *In re Commonwealth Cos.*, 913 F.2d 518 (8th Cir. 1990)

MCorp nevertheless argues that the "police or regulatory power" exception should not apply here because the Board's regulatory action may have the effect of allowing the Board "to obtain possession of or exercise control over a debtor's property or to assess or recover a claim." MCorp Br. 15, citing 11 U.S.C. 362(a)(3) and (6). The difficulty with that argument is that it completely ignores the regulatory character of the Board's proceedings. The Board initiated its administrative proceedings to determine whether MCorp has violated federal statutory or regulatory requirements and to determine what, if any, actions are necessary to put MCorp's operations in compliance with the law. See 12 U.S.C. 1818(b)(1). The mere conduct of an administrative proceeding under the Board's cease-and-desist authority does not amount to the assertion of any control over property of the debtor or in the collection or recovery of a claim against a debtor.[6]

(government's False Claim Act action to recover money damages and civil money penalty exempt from automatic stay); *Brock* v. *Rusco Indus.*, 842 F.2d 270, 273 (11th Cir.) (Fair Labor Standards Act action to recover unpaid minimum wages exempt from automatic stay), cert. denied, 488 U.S. 889 (1988); *In re Berry Estates*, 812 F.2d 67, 71 (2d Cir.) (rent control proceedings exempt from automatic stay), cert. denied, 484 U.S. 819 (1987); *NLRB* v. *Edward Cooper Painting, Inc.*, 804 F.2d 934, 941-942 (6th Cir. 1986) (NLRB unfair labor practice proceedings for back wages exempt from automatic stay); *Cournoyer* v. *Town of Lincoln*, 790 F.2d 971 (1st Cir. 1986) (action to enforce zoning restrictions on land use exempt from automatic stay); *CFTC* v. *Co Petro Mktg. Group*, 700 F.2d 1279 (9th Cir. 1983) (CFTC action to enjoin violations of Commodity Exchange Act exempt from automatic stay); *SEC* v. *First Financial Group*, 645 F.2d 429, 437 (5th Cir. 1981) (SEC proceeding to enjoin fraudulent sales of securities exempt from automatic stay).

[6] MCorp also cites (Br. 15) the Board's issuance of a temporary cease-and-desist order to suggest that the Board has done more than simply conduct administrative proceedings. However, the relevant provisions of the Board's October 1988 temporary order, which sought MCorp's compliance with the source of strength policy, were

If the Board determines that MCorp has violated federal banking law and regulations, the Board "*may* issue * * * an order to cease and desist from any such violation or practice." 12 U.S.C. 1818(b)(1) (emphasis added). The fact that a cease-and-desist order *might* direct MCorp to expend money, either to recapitalize its subsidiary banks or to make restitution for past violations, does not change the regulatory character of the current administrative action.[7]

MCorp also notes (Br. 21) that failure to comply with a final administrative order can give rise to liability for a substantial civil money penalty. See 12 U.S.C. 1818(i)(2). As MCorp recognizes elsewhere (Br. 14 n.12), however, an agency's efforts to fix money damages for a

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suspended by the Board shortly after the order was issued, pending MCorp's negotiations with the FDIC. J.A. 184-185. The Board has not reinstated those provisions and they have no effect on MCorp.

[7] This Court observed in *Ohio* v. *Kovacs*, 469 U.S. 274 (1985), that the "automatic stay provision does not apply to suits to enforce the regulatory statutes of the State," and distinguished the prosecution of regulatory actions from "the enforcement of such a judgment by seeking money from the bankrupt." *Id.* at 283 n.11. Here, the prosecution of the regulatory action—rather than the enforcement of any resulting order—is at issue, and MCorp's speculation about the issuance and content of any order is *only* speculation at this juncture. If the Board ultimately issues an order, that order may be "stayed, modified, terminated, or set aside by action of the agency or a reviewing court," 12 U.S.C. 1818(b)(2) and (h)(2).

Contrary to MCorp's suggestion (Br. 12), the Board has not conceded that the automatic stay would necessarily apply if the Board actually issues an order at the end of the administrative proceedings. It is by no means clear that enforcement of an order requiring, for example, that MCorp recapitalize its *own* subsidiary banks to satisfy its regulatory obligations can be equated with the enforcement of a money judgment requiring payment of a sum to a third party. Cf. *Kovacs*, 469 U.S. at 283-284 n.11. And contrary to MCorp's suggestion (Br. 15), the Board has never required a bank holding company to transfer assets to the receivers of a closed bank.

violation of law is exempt from the automatic stay.[8] The mere prospect of future assessment of a civil penalty for violation of a cease-and-desist order that has yet to be issued is not sufficient to render the Board's cease-and-desist proceeding an action "to collect, assess, or recover a claim against the debtor," 11 U.S.C. 362(a)(6).[9]

Finally, even if MCorp were correct in asserting that the automatic stay applies to the Board's enforcement actions, the stay provisions would require only that the Board refrain from prosecuting its actions during the bankruptcy case and would not empower a court to review the substantive validity of the Board's regulations and policies. See 11 U.S.C. 362(a) (restraining the "commencement or continuation" of various proceedings). Thus, even under MCorp's theory of the case, the Bankruptcy Code's automatic stay provisions would not be adequate to support the court of appeals' judgment in this case, which prohibits the Board from ever enforcing its source of strength policy against MCorp. See J.A. 36.

2. MCorp also contends, as an alternative to its argument based on the Bankruptcy Code's automatic stay

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[8] The courts of appeals have repeatedly held that an administrative action to reduce a monetary claim to an administrative judgment is not stayed under the Code. See, *e.g.*, *NLRB* v. *P*I*E Nationwide, Inc.*, 923 F.2d 506, 512 (7th Cir. 1991); *United States* v. *Nicolet, Inc.*, 857 F.2d 202, 209 (3d Cir. 1988); *EEOC* v. *Rath Packing Co.*, 787 F.2d 318 323-326 (8th Cir.), cert. denied, 479 U.S. 910 (1986); *NLRB* v. *Edward Cooper Painting, Inc.*, 804 F.2d at 943. See also H.R. Rep. No. 595, *supra*, at 343. Cf. *Nathanson* v. *NLRB*, 344 U.S. 25, 30 (1952) (bankruptcy court should defer to administrative agency's expertise and allow agency to liquidate money claim within agency's administrative expertise).

[9] The need for a stay would arise, if at all, only *after* the Board issues a final cease-and-desist order. See 12 U.S.C. 1818(i)(2). FISA itself confers jurisdiction for the issuance of a stay after the issuance of the cease-and-desist order but prior to the assessment of civil penalties. 12 U.S.C. 1818(h)(2); see 12 U.S.C. 1818(b)(2). Thus, FISA and the Bankruptcy Code are entirely consistent in permitting the Board to complete its cease-and-desist proceedings prior to judicial intervention.

provisions, that "the district court has jurisdiction under Section 1334 to enjoin the Board's administrative proceedings pursuant to Section 105(a) of the Bankruptcy Code." Br. 17-26. That argument tacitly acknowledges, at least, that an injunction cannot issue unless the district court has a valid basis for exercising jurisdiction. The difficulty with the argument, however, is that there is nothing in 28 U.S.C. 1334 or 11 U.S.C. 105(a) that purports to repeal—or that even makes reference to—FISA's jurisdictional limitations.

MCorp attempts to find support in 28 U.S.C. 1334(b), which gives the district courts original, non-exclusive jurisdiction of "civil proceedings arising under title 11, or arising in or related to cases under title 11," and 28 U.S.C. 1334(d), which gives the district courts exclusive jurisdiction "of all of the property, wherever located, of the debtor * * * and of property of the estate." But whatever the content of those general jurisdictional grants, they remain subject to Section 1818(i)'s express limitation:

> except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

12 U.S.C. 1818(i). Section 1334 cannot give a district court jurisdiction to enjoin the Board's ongoing administrative proceedings because Section 1818(i) expressly provides that *no court* shall have that power. Moreover, as we have shown (Gov't Br. 26-28), Section 1334(b) and Section 1334(d), by their terms, are not applicable to the Board's administrative proceedings.[10]

[10] MCorp contends that the conclusion that the district courts do not have bankruptcy jurisdiction over the Board's administrative proceedings would be "faulty, illogical, and without precedent" (Br. 25). That conclusion, however, is compelled by the plain language of the statutes involved. Section 1334(b) does not purport to reach or affect the jurisdiction of administrative agencies. Instead, as the court of appeals explained (J.A. 17), Section 1334(b) gives the bankruptcy court concurrent jurisdiction over "civil proceedings" that would lie within the exclusive jurisdiction of another "court." 28 U.S.C. 1334(b). The ordinary meaning of the statutory terms "court" and "civil proceeding" do not encompass proceedings pending before an administrative tribunal. Cf. *Melkonyan* v. *Sullivan*, No. 90-5538 (June 10, 1991), slip op. 6-7 (statutory reference to "final judgment" in a "civil action" refers to order entered by a court, not the final decision of an administrative tribunal). Similarly, Section 1334(d) merely gives the court *in rem* jurisdiction to resolve issues affecting title to or control of the debtor's property. As such, it does not cover every controversy that may ultimately affect the estate, see *Callaway* v. *Benton*, 336 U.S. 132, 142 (1949), and it plainly does not bar the mere commencement and prosecution of regulatory proceedings to correct unsafe banking practices. Significantly, where Congress has intended that a bankruptcy provision extend to administrative proceedings, it said so expressly. See 11 U.S.C. 362(a)(1) (providing for a stay of certain "judicial, *administrative*, or other action[s]" against the debtor) (emphasis added). Moreover, the result that we urge is consistent with the familiar and sensible principles of ripeness, exhaustion of remedies, and finality.

At bottom, MCorp asks this Court to find an implied repeal of Section 1818(i). As we explained in our opening brief (at 21-22), there is a strong presumption against implied repeals in general and against implied repeals of jurisdictional limitations in particular. Here, MCorp's request for an implied repeal rests on nothing more than the nebulous assertion that the private pecuniary interests of the debtor and its creditors must take precedence over the public interest in bank safety. The court of appeals correctly concluded that the Bankruptcy Code does not require that startling result. J.A. 16-22.[11]

[11] MCorp has continued to operate a banking business during the pendency of the bankruptcy proceedings at issue here. Yet the upshot of its argument is that the filing of a bankruptcy petition disables the Board from enforcing the regulatory requirements that apply to any other bank holding company. Thus, in MCorp's view, the bankruptcy laws create a safe harbor from federal regulation, thereby ensuring that the debtor's ability to advance the private economic interests of its shareholders and creditors is not hampered by any obligation to cease and desist from unsafe or unsound banking practices. A business, however, cannot simply cast aside federal regulation by filing a bankruptcy petition. As this Court has re-

3. MCorp next makes a novel argument that the court of appeals "had jurisdiction to rule on * * * the question of the Board's statutory authority to exercise its alleged source-of-strength assessment authority" because the district court whose decision was under review (the U.S. District Court for the Southern District of Texas) could have assumed jurisdiction, under 28 U.S.C. 1334(b), over a pending suit in a different district court (the U.S. District Court for the Northern District of Texas) that raised a challenge, under 12 U.S.C. 1818(c)(2), to the Board's temporary cease-and-desist orders against MCorp. Br. 27-28.

This convoluted argument is flawed at every turn. First, MCorp did not raise this argument below, neither the court of appeals nor the district court sitting in bankruptcy even considered MCorp's unusual theory, and they did not purport to rule on issues pending in other courts.[12] Second, it is far from clear (and we do not concede) that a district court sitting in bankruptcy could have exercised jurisdiction, under 28 U.S.C. 1334(b), over a Section 1818(c)(2) challenge pending in another district court. That would depend on, among other things, whether the Section 1818(c)(2) challenge is a civil proceeding "related to cases under title 11." 28 U.S.C. 1334(b). Third, Section 1818(c)(2) in any event empowers the district court only to issue an order "setting aside, limiting, or suspending the enforcement, operation, or effectiveness of [a temporary cease-and-desist] order *pending the completion of the administrative proceedings* pursuant to the notice of charges served * * *." 12 U.S.C. 1818(c)(2) (emphasis added). Section 1818(c)(2) does *not* permit the district court to review or otherwise interfere with the final resolution of the administrative charges—Section 1818(h)(2) places that review within the exclusive preserve of the court of appeals. Cf. *Mid-America Bancorporation* v. *Board of Governors*, 523 F. Supp. 568, 577-578 (D. Minn. 1980). Not surprisingly, MCorp does not cite a single precedent for its novel jurisdictional argument. MCorp's contention as to what the court of appeals "had jurisdiction" to do is simply a red herring.

peatedly recognized, the filing of a bankruptcy petition does not give a bankruptcy trustee or a debtor-in-possession "*carte blanche* to ignore nonbankruptcy law." *Midlantic Nat'l Bank* v. *New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 502 (1986). See *Ohio* v. *Kovacs*, 469 U.S. at 285; *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 534 (1984).

[12] As we have explained (note 6, *supra*), the source of strength provisions in the Board's temporary order had been indefinitely suspended by the time of the district court action here. Hence, there was no live controversy with regard to that portion of the temporary order, and no basis, even under MCorp's theory, for a court to adjudicate the validity of the source of strength policy.

B. Non-Bankruptcy Law Does Not Give The Courts Jurisdiction To Restrain the Federal Reserve Board's Enforcement Proceeding

1. The court of appeals did not rely on any of MCorp's bankruptcy-based arguments to sustain the district court's jurisdiction. Instead, the court of appeals held that the district court could enjoin the Board's proceedings based on the narrow principle set forth by *Leedom* v. *Kyne*, 358 U.S. 184 (1958). MCorp all but abandons the court of appeals' reasoning, relegating its discussion of *Leedom* to the last few pages of its 50-page brief.

MCorp asserts (Br. 46-48) that the district court's exercise of jurisdiction is appropriate under *Leedom* because the Board misconstrued the scope of its delegated powers in adopting the source of strength policy. A litigant cannot invoke a court's jurisdiction under *Leedom*, however, by simply alleging that the agency has made an error in construing the scope of its authority. Rather, this Court's decision in *Leedom* holds only that an "inference" of federal court jurisdiction may arise where the " 'absence of jurisdiction of the federal courts' would mean 'a sacrifice or obliteration of a right which Congress' has given * * *." *Leedom*, 358 U.S. at 190. This case does not involve that situation. MCorp will have a full opportunity to obtain review of the Board's action, in accordance with 12 U.S.C. 1818, once the Board has issued a final decision.

Although MCorp briefly asserts that the district court would have jurisdiction under *Leedom*, it has no response to the arguments set forth in our opening brief. See Gov't Br. 29-36. MCorp does not explain why a court should rely on "inferred" jurisdiction based on *Leedom* where Congress has enacted a fully adequate, statutory basis for obtaining judicial review of the Board's final orders. See 12 U.S.C. 1818(h)(2).[13] MCorp does not explain how the mere filing of administrative charges, which does not constitute a final agency action binding the parties, can amount to an *ultra vires* act of such extreme impact as to warrant *Leedom*'s inference. And MCorp does not explain how the Board's resolution of an issue of statutory construction can amount to an *ultra vires* act when the court of appeals itself found that "Congress has not spoken clearly" to the issue (J.A. 33) and that the question is therefore governed by the second step of the analysis set out in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)—a step that presupposes that Congress has delegated authority to the agency to construe the meaning of the pertinent statutory terms. See *id.* at 844-845; Gov't Br. 33.

This Court has made clear that its decision in *Leedom* represents a narrow, rarely invoked exception to ordinary principles of judicial review. See, *e.g.*, *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 481 (1964). MCorp's approach, however, would transform *Leedom* into a general source of judicially created jurisdiction and invite the lower courts to circumvent explicit congressional limitations on their power.

2. MCorp further argues that it should not be required to comply with the requirements of 12 U.S.C. 1818 —which effectively requires MCorp to exhaust its administrative remedies before seeking judicial review, see note I, *supra*—because "exhaustion is not necessary when the dispute concerns a purely legal issue." MCorp Br. 48-49, citing, *e.g.*, *McKart* v. *United States*, 395 U.S. 185, 197 (1969). The issue, however, is not what the "judicial" doctrine of exhaustion requires, *McKart*, 395 U.S. at 193, but rather what Congress has required. Section 1818 provides that "no court" shall have jurisdiction to enjoin a Board notice or order except under the conditions set forth therein. 12 U.S.C. 1818(i). The courts are obligated to comply with Congress's jurisdictional limitations, irrespective of any judicially created rules concerning exhaustion of administrative remedies. See *Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 579 (1989) ("Our past cases have recognized that exhaustion of administrative remedies is required where Congress imposes an exhaustion requirement by statute.").

3. MCorp also incorrectly suggests in passing (Br. 49) that the court of appeals had jurisdiction, under 28 U.S.C. 2106, to direct the district court to enter the injunction against the Board. Section 2106—which provides that a court of appeals "may affirm, modify, vacate, set aside or reverse" any judgment brought before it for review—does not cure the district court's complete lack of jurisdiction to enjoin the Board's ongoing administrative proceeding. See *Mitchell* v. *Maurer*, 293 U.S. 237, 244 (1934) ("An appellate federal court must satisfy itself not only of its own jurisdiction, but also of that of the lower courts in a cause under review."). The authority granted under Section 2106 is, in any event, also subject to the limitations imposed by 12 U.S.C. 1818(i).

[13] This Court has repeatedly held that "a precisely drawn, detailed statute pre-empts more general remedies." *Block* v. *North Dakota*, 461 U.S. 273, 285 (1983). See, *e.g.*, *Great American Savings & Loan Ass'n* v. *Novotny*, 442 U.S. 366, 375-377 (1979); *Brown* v. *GSA*, 425 U.S. 820, 833 (1976).

C. The Board's Source of Strength Policy Is Based On A Valid Exercise Of The Board's Statutory Authority

Section 1818(i) means what it says. By its plain terms, it precludes the courts below from reviewing and enjoining the Board's ongoing proceedings, and accordingly there is no occasion at this juncture for judicial review of the validity of the Board's actions. MCorp nevertheless devotes a large portion of its brief to chal-

lenging the validity of the Board's source of strength policy. Despite the cardinal rule of statutory construction that "the starting point for interpreting a statute is the language of the statute itself," *Consumer Product Safety Comm'n* v. *GTE Sylvania*, 447 U.S. 102, 108 (1980), MCorp largely ignores the relevant statutory language and launches into a winding exegesis of repealed statutes, unenacted legislative proposals, and statutory provisions other than those governing the Board's regulatory powers. The few shots that MCorp does aim at the pertinent statutory scheme fail to demonstrate that the Board's source of strength policy is invalid.

1. We explained in our opening brief (at 36-45) that the Board's source of strength policy is based on a reasonable construction of the Board's remedial powers under FISA, the BHCA, and ILSA. FISA, as amended by section 902 of FIRREA, gives the Board broad authority to remedy unsafe and unsound banking practices and specifically empowers the Board to order bank holding companies to make restitution to subsidiaries, to dispose of a loan or asset, or to "take such other action as [the Board] determines to be appropriate." 12 U.S.C. 1818 (b)(1) and (6).[14] As the court of appeals recognized (J.A. 30), Congress has not expressly defined what constitutes an unsafe or unsound banking practice requiring the exercise of these remedial powers. Instead, it left the development of appropriate standards to the regulatory agencies. Thus, under this Court's decision in *Chevron*, the Board's conclusion that a bank holding company's failure to act as a source of strength for its subsidiary banks constitutes an unsafe practice must be upheld unless it is an unreasonable or impermissible construction of the statute. See Gov't Br. 37.

MCorp does not contest the court of appeals determination that the source of strength policy must be assessed

[14] MCorp notes that the FIRREA amendments were enacted after the district court's decision (Br. 45), but it does not contest our assertion that these amendments apply to the administrative charges now pending against MCorp.

under *Chevron*'s deferential standard of review. Nor does MCorp assert that the Board's objective of promoting the safety and capital adequacy of subsidiary banks is somehow inconsistent with Congress's intent to prevent unsafe banking practices. Instead, MCorp maintains that: (a) Congress did not intend to give the Board "a blank check" to regulate any unsafe practice; (b) if Congress believed that the Board had authority to enforce the source of strength policy, it would not have subsequently strengthened the FDIC's remedial powers; and (c) the FIRREA amendments clarifying the Board's remedial powers are limited to "restitutionary type" remedies. MCorp Br. 43-45.

MCorp's arguments have no merit. First, the Board does not claim "blank check" regulatory authority; it asserts, in the context of a source of strength proceeding, only the authority to remedy holding company conduct that threatens the financial stability of a subsidiary bank—*i.e.*, conduct that is "unsafe and unsound." Second, Congress's recent enactment of the FDIC's cross-guarantee authority has no bearing on the Board's interpretation of different, previously enacted statutory provisions.[15] Congress's conclusion that the FDIC required special assessment powers after a bank failure says nothing at all about the substantive validity of the Board's policies, which are designed to prevent such a failure. Finally, MCorp's efforts to limit the FIRREA amendments to "restitutionary type" remedies is at odds with the plain language of the statute. The statute on its face empowers the Board to order bank holding companies to divest themselves of assets or "take such other actions as [the Board] determines to be appropriate." There is nothing in the

[15] The FDIC powers cited by MCorp permit the FDIC to assess a bank controlled by a holding company for the losses incurred by the FDIC as the result of the failure of another bank controlled by the same holding company. 12 U.S.C. 1815(c). The source of strength policy entails a markedly different remedial power, one that permits the Board to order an infusion of the parent *holding company*'s assets *before* the affiliated bank becomes insolvent.

text of the statute purporting to limit that power to "restitutionary" remedies. See *Freytag* v. *Commissioner*, No. 90-762 (June 27, 1991), slip op. 5 ("[C]ourts 'are not at liberty to create an exception where Congress has declined to do so.' *Hallstrom* v. *Tillamook County*, 493 U.S. 20, —— (1989).").

MCorp does not come to grips with our submission that the source of strength policy is rooted in the Board's authority under the BHCA to consider the "future prospects" of subsidiary banks when approving a holding company's acquisition of a bank subsidiary, 12 U.S.C. 1842(c), and the Board's related authority under ILSA to set minimum capital requirements for bank holding companies, 12 U.S.C. 3907(b). See Gov't Br. 37-44. MCorp acknowledges (Br. 39) that the Board can require a holding company to demonstrate its financial and managerial soundness at the time the company seeks permission to acquire a bank, and it also acknowledges (Br. 43) that the Board has power under ILSA to set minimum capital requirements for holding companies and nonbank subsidiaries. MCorp nevertheless argues (Br. 43) that the Board cannot require a holding company to use the Board-mandated capital levels as a source of strength for subsidiary banks after a bank acquisition is completed.

MCorp's argument is inconsistent with Congress's regulatory scheme. As we have explained, Congress gave the Board the power to set and enforce the appropriate minimum capital standards *in tandem* with a grant of express authority to prevent a holding company from engaging in unsafe and unsound practices that might jeopardize the company's subsidiary banks. See 12 U.S.C. 1818(b). The Board has adopted its source of strength policy—which requires that the bank holding company employ its available capital to promote the safety of subsidiary banks during periods of financial instability—to ensure that the congressionally authorized capital requirements are not frustrated in a manner that would threaten the safety and soundness of the company's banks. Thus,

the Board's policy effectuates Congress's intent. MCorp, by contrast, offers no explanation as to why Congress would grant the Board power to set and enforce capital standards for holding companies, but deny the Board power to ensure that a bank holding company employs its available capital to promote the safety of its subsidiaries.[16]

2. Much of MCorp's attack on the substantive validity of the Board's policy focuses, not on the statutes currently in force, but on provisions of the National Bank Act that were repealed more than 30 years ago. See MCorp Br. 29-32. MCorp essentially argues that: (a) those provisions incorporated a "shareholder assessment" requirement; (b) Congress irrevocably rejected such requirements in repealing the pertinent statutory provisions; and (c) the Board's source of strength policy imposes the very same "shareholder assessment" rejected by Congress.

MCorp relies on the questionable notion that Congress's intent in enacting FISA and the Bank Holding Company Act can be discerned from the actions of an entirely different Congress with respect to some other statutory scheme. MCorp essentially contends that the National Bank Act's shareholder assessment provisions and the Board's source of strength doctrine are essentially the same, and that Congress's views as to the former should be imputed as to the latter. The logic of that argument fails, however, because the two regimes are quite differ-

[16] MCorp also maintains (Br. 41-42) that the Board has only recently "discovered" the authority to impose on holding companies an on-going obligation to act as a source of strength to bank subsidiaries. That assertion is incorrect. The Board, long before the 1987 promulgation of the source of strength policy statement, relied on such authority in undertaking negotiations and other informal supervisory actions calculated to obtain a holding company's cooperation in ensuring that banking subsidiaries remain adequately capitalized. See 90-913 Pet. 15 & n.13. Cf. *United States* v. *Gaubert*, 111 S. Ct. 1267, 1274 (1991) (in addition to issuing regulations, agencies can establish policy "on a case-by-case basis, whether through adjudicatory proceedings or through administration of agency programs").

ent. The National Bank Act's assessments on bank shareholders were to be collected only *after* the bank had failed, in order to reduce losses incurred by the bank's creditors.[17] The Board's source of strength policy, in contrast, is *remedial* and *prospective* in nature. It is designed to prevent the failure of a bank—and the resulting losses to depositors and other creditors—by requiring the bank's parent holding company to provide needed capital *before* the bank fails.

There also is no logical connection between Congress's repeal of the shareholder assessment provisions and the validity of the Board's source of strength policy. Congress repealed the shareholder assessment provisions because they unfairly burdened small investors.[18] The Board's source of strength policy does not impose the same unfair burdens on small investors. The Board's policy imposes obligations only on the parent holding company to use "available resources," during periods of financial stress or adversity, to support its subsidiary banks. See Gov't Br. 7; 52 Fed. Reg. 15,707 (1987). Thus, the only bank shareholder subjected to the Board's regulatory authority is the one shareholder that exercises control over the bank and that can be held responsible for the bank subsidiary's operations, policies, and financial condition.

[17] Act of June 3, 1864, ch. 106, § 12, 13 Stat. 99, formerly codified at 12 U.S.C. 63. The statute directed the bank's receiver to enforce the required assessment where necessary to pay the bank's debts, ch. 106, § 50, 13 Stat. 114-115, formerly codified at 12 U.S.C. 192. See also Act of Dec. 23, 1913, ch. 6, § 2, 38 Stat. 273, formerly codified at 12 U.S.C. 64 (conferring similar assessment authority against stockholders who transferred shares within 60 days of the bank's failure).

[18] As Representative Steagall explained, the provisions often resulted in the dominant, managing shareholders, selling their stock before an assessment was imposed, leaving liable the small shareholders who had no part in the management or policies of the failed bank, who would not have the information needed to foresee the bank's impending insolvency, and who might not have the resources to pay the assessment. See 77 Cong. Rec. 3947 (1933).

3. MCorp's remaining substantive arguments (Br. 33-38) attempt to draw an adverse inference from Congress's failure to codify the Board's source of strength policy. No conclusions, however, can fairly be drawn from Congress's failure to enact legislation. Congressional inaction is inherently unenlightening; for example, congressional inaction here could just as easily be attributed to an affirmative recognition that the Board already had the necessary authority to adopt a source of strength policy. This Court has repeatedly stated its reluctance to draw any inferences from Congress's mere failure to enact a bill into law. See, *e.g.*, *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 306 (1988). MCorp offers no explanation why an exception should be made in this case.

Nor is there any basis for MCorp's suggestion (Br. 35-36) that Congress implicitly rejected the Board's source of strength policy when it enacted FIRREA's cross-guarantee provisions. As we have observed (note 15, *supra*), the source of strength policy and the FDIC's cross-guarantee authority differ in purpose and scope. There is simply no basis for believing that Congress intended to withdraw the Board's power to *prevent* a bank insolvency by authorizing the FDIC to reach bank assets *after* a default has occurred.[19]

[19] MCorp's efforts (Br. 34-35) to inflate the significance of the FDIC's views on the wisdom of the Board's source of strength policy statement are also unpersuasive. Some of the comments attributed to the FDIC are drawn from a *draft* report and are thus of dubious value in describing the "official" views of the agency. See MCorp Br. 34-35 & n.51. Moreover, the notion that a draft *agency* report "shaped congressional debate" on the FIRREA legislation and is therefore a reflection of the views of *Congress* is inconsistent with the well-established principle that remarks "made in the course of legislative debate or hearings other than by persons responsible for the preparation or the drafting of a bill are entitled to little weight." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 204 n.24 (1976). Indeed, although MCorp attaches great significance to the legislative consideration of FIRREA, it is unable to cite one statement made by a member of Congress during legislative consideration of FIRREA that expresses criticism of the source of strength policy.

4. MCorp relegates to a footnote (Br. 41 n.73) the new argument that the source of strength policy amounts to a substantive rule that has not been properly promulgated under the notice and comment procedures of Section 553 of the Administrative Procedure Act. One reason why such a portentous argument is discreetly tucked away may be that it was not presented to either the district court or the court of appeals. For that reason alone, MCorp's claim is not properly before this Court. *E.g.*, *Demarest* v. *Manspeaker*, 111 S. Ct. 599, 602-603 (1991). In any event, the Board's policy statement did not in fact create new substantive obligations but merely explained and clarified existing agency practices developed over the course of its enforcement activities. See note 16, *supra*. MCorp is thus wrong in asserting that the Board's source of strength policy statement announced a new substantive rule requiring notice and comment rulemaking.

CONCLUSION

The judgment of the court of appeals should be affirmed to the extent that it vacates the district court's injunction with respect to proceedings on the Board's Section 23A charges, and the judgment should be reversed to the extent that it remands the case with instructions to enjoin proceedings on the Board's source of strength charges.

Respectfully submitted.

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Nos. 90-913 and 90-914

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

MCORP, MCORP FINANCIAL INC. and
MCORP MANAGEMENT

and

OFFICIAL CREDITORS' COMMITTEE OF MCORP,
MCORP FINANCIAL INC. and MCORP MANAGEMENT,
Respondents.

MCORP, *et al.*
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

**On Writs of Certiorari to the
United States Court of Appeals
for the Fifth Circuit**

SUPPLEMENTAL JOINT BRIEF OF MCORP, *et al.*

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INTRODUCTION

This Supplemental Brief is submitted to advise the Court of intervening developments that had not occurred and matter that was not available in time to be included in the Joint Brief of MCorp *et al.* filed on June 10, 1991, and to advise the Court of a material misstatement of fact contained in the Reply Brief of the Board of Governors of the Federal Reserve System (the "Board").[1]

I. THE BOARD'S CONTENTION THAT ILSA PROVIDES AUTHORITY TO IMPOSE A SOURCE-OF-STRENGTH ASSESSMENT AGAINST A BANK HOLDING COMPANY IS INCONSISTENT WITH THE POSITION TAKEN BY THE UNITED STATES BEFORE THIS COURT IN *BANK OF COUSHATTA v. FDIC*

The Board argues that the International Lending Supervision Act, 12 U.S.C. § 3907 ("ILSA"), provides a statutory basis for the Board's purported authority to levy and enforce source-of-strength assessments requiring bank holding companies to recapitalize their subsidiary banks. Board Br. at 38-39; Board Reply Br. at 16. In support of this argument, the Board relies on Section 3907(a), which authorizes the appropriate federal banking agency to set capital standards for "banking institutions" under its jurisdiction. Board Br. at 38. This argument, however, directly contradicts the position taken by the United States in its Brief In Opposition in *Bank of Coushatta* v. *Federal Deposit Insurance Corporation, petition for certiorari pending* No. 91-24, filed with this Court in August 1991.

The provision of ILSA, 12 U.S.C. § 3907(a), on which the Board predicates its claimed source-of-strength assessment authority, authorizes the appropriate federal bank

[1] MCorp is the parent company of both MCorp Financial Inc. and MCorp Management. MCorp, MCorp Financial Inc. and MCorp Management have only wholly owned subsidiaries.

regulator to establish minimum capital levels for "banking institutions" under its jurisdiction. Section 3907 also authorizes the appropriate federal bank regulator to enforce such minimum capital levels against "banking institutions" through the issuance of "capital directives." A bank holding company such as MCorp, however, is not a "banking institution" within the meaning of ILSA. 12 U.S.C. § 3902(2). The United States acknowledges this point in its Brief in Opposition in *Bank of Coushatta*, in which it affirmatively asserts that the term "banking institution" does not include a bank holding company, and that a capital directive therefore cannot be issued against a bank holding company. In the words of the United States, "*capital directives may issue only against 'banking institutions,' 12 U.S.C. § 3907(a), not bank holding companies. Therefore, a capital directive cannot impose requirements on a bank holding company such as were imposed in MCorp.*" [2]

The Board's claim that ILSA provides it with authority to issue a source-of-strength assessment against a bank holding company is not only wholly unsupportable for the reasons stated in MCorp's principal brief at 43, but it also is completely inconsistent with the position taken by the United States in *Bank of Coushatta*.

II. RECENT CONGRESSIONAL DEVELOPMENTS

A. Testimony of FDIC and SEC Chairmen in Opposition to Source-of-Strength Assessment Power

Because the Board relies almost entirely on its own policy arguments in support of its alleged source-of-strength assessment authority, the Court may wish to consider the contrary views of two other federal agencies recently expressed to Congress regarding source-of-strength.

On June 20, 1991, Richard Breeden, Chairman of the Securities and Exchange Commission ("SEC"), testified

[2] Brief of the United States in Opposition, in *Bank of Coushatta v. Federal Deposit Insurance Corporation*, at 12 n.8 (No. 91-24, August 1991) (emphasis added).

in opposition to the legislative source-of-strength assessment proposal pending before the House Subcommittee on Telecommunications and Finance:

> The Commission is concerned that the "source of strength" provisions in H.R. 1505 could have undesirable effects on the capital markets. Under the bill FSHCs [financial services holding companies, a term replacing bank holding companies in the legislation] with undercapitalized banking subsidiaries would have to maintain consolidated capital at identified levels . . . .
>
> *These source of strength provisions would almost certainly discourage investments in depository institutions.* In this manner, the consolidated capital requirements of H.R. 1505 could reduce the intended benefits to the banking system of increasing access to outside capital and management and of authorizing FSHCs to offer broader financial services.[3] (Emphasis added.)

The SEC's position on the effects of source-of-strength assessments on our financial system echoes the oft-repeated comments of the FDIC.[4] FDIC Chairman Seidman recently testified in opposition to the source-of-strength provisions in pending legislation. In his written testimony, FDIC Chairman Seidman stated the FDIC's position on the "source-of-strength" assessment provisions as follows:

> [The FDIC has] concerns about legislatively mandating that holding companies act as a "source of strength" to their affiliated organizations. A "source of strength" requirement could undermine the goals

[3] Written Testimony of Richard Breeden, Chairman, SEC, before House Subcomm. on Telecommunications and Finance, June 20, 1991 at 30-31. Chairman Breeden also expressed concern over the potentially harmful effect that a source-of-strength requirement would have upon the capital levels of broker-dealer firms owned by bank holding companies. *Id.*

[4] *See* MCorp Br. at 29, 32, 34-36. The Board's suggestion that the FDIC has not officially taken a position on "source-of-strength" assessments is thus incorrect. Board Reply Br. at 19 n.19.

of limited corporate liability envisioned by having separate bank affiliates. Also, if such ownership burdens are mandated by Congress, they would make investments in bank equities unattractive. Right now particularly, we need to encourage investment in banks, not discourage it. Many bank stocks prior to the mid-1930's were subject to additional assessments if a bank experienced financial difficulties. Congress removed this requirement because of its negative effect on the ability of banks to raise new capital.[5]

The FDIC, like the Board, is charged with administering the Financial Institutions Supervisory Act ("FISA"), codified in Section 8 of the Federal Deposit Insurance Act, 12 U.S.C. § 1818, and ILSA, 12 U.S.C. § 3907, two of the statutes on which the Board relies for its alleged source-of-strength assessment authority. The FDIC's continuing official position that neither FISA, ILSA nor any other law provides any statutory basis for the Board's claimed source-of-strength assessment power, and the FDIC's criticism of the policy and economic wisdom of such assessments, preclude any basis for the Board's contention that *Chevron*[6] compels this Court to defer to the Board's administrative interpretation of these same banking statutes.

B. Pending Legislation

Congress repeatedly has considered and rejected various formulations of a source-of-strength assessment authority. MCorp Br. at 33-38. Congress again is considering

[5] *Financial Industry Reform and Capital Enforcement Act (H.R. 192): Hearing Bef. Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs,* at 80 (1991) (written testimony of L. William Seidman, Chairman, FDIC). Although this House hearing took place on February 28, 1991, the hearing report was not available in time to be included in MCorp's principal brief.

[6] *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

legislation that would, if enacted, for the first time since the repeal of shareholder liability in the 1930's, statutorily authorize source-of-strength assessments against bank holding companies.

This continuing congressional consideration of source-of-strength assessments demonstrates that: (1) the Board presently lacks statutory authority to impose source-of-strength assessments on bank holding companies; (2) the source-of-strength authority that Congress has under consideration is significantly more limited in scope than that claimed by the Board under its self-declared source-of-strength assessment policy; and (3) a grant of source-of-strength assessment power would involve a substantial change in current law with major economic implications and is a power that only Congress, and not this Court or the Board, properly can grant.[7]

Both the House and Senate currently are considering legislation that would grant the federal bank regulators a limited source-of-strength assessment power. Unlike the Board's unilaterally declared source-of-strength assessment power, the pending legislative initiatives are limited in scope and effect and would allow a bank holding company to choose between adding capital and divesting the bank.

The operation of one proposed limited source-of-strength assessment authority was explained by Robert Glauber, Deputy Undersecretary of Finance, Department of Treasury, when he testified regarding the Administration's bill (H.R. 1505 and S. 713):

> What we propose is that at such time as the bank would cross below the fully-capitalized threshold, which would be 8 percent in the near future, that immediately the holding company either has to fill up the capital again, get rid of the bank or subject itself to bank-like kinds of regulation.
>
> We think that is enough. There are other proposals that would allow the regulators to call back capital from the commercial firm. I think that in deciding

[7] *See generally* MCorp Br. at 29-45.

what is a suitable set of regulations, you have to balance the need to make certain the bank won't become a ward of the Fund and cost the Fund money, and at the same time, pose an attractive opportunity for the commercial firms, which as you have suggested, have most of the capital.[8]

On July 23, the House Committee on Banking, Finance and Urban Affairs reported a bill, H.R. 6, that would grant a different, limited statutory source-of-strength power to the federal banking regulators. The House bill would require, as a condition to federal regulatory approval of an undercapitalized financial institution's capital improvement plan, that the parent company provide a written guaranty, for a period ending 12 months after the bank achieves regulatory capital compliance, that the bank will comply with the capital plan. The amount of the parent company's liability under such a written commitment, however, would be limited to the amount of money that would have been required to place the bank into regulatory capital compliance as of the date of the commitment. H.R. 6, § 131(f), 102d Cong., 1st Sess. (July 23, 1991). If the parent company failed to make such a written commitment, the capital plan could not be approved. The bank would be subject to operating restrictions, and potential forced sale of securities or divestiture, *but the parent company would not be liable to infuse capital into the subsidiary bank. See* H.R. 6, § 131(g), (i).

The House Bill also would require a "Financial Services Holding Company" ("FSHC," a term replacing "bank holding company" in the Bill) that either engages in new activities permitted by the legislation or that is controlled by a "Diversified Holding Company" ("DHC,"

[8] *Financial Institutions Safety and Consumer Choice Act of 1991: Hearings Bef. Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 102d Cong., 1st Sess. at 15-16 (Mar. 21, 1991) (testimony of Robert Glauber, Deputy Undersecretary of Finance, Department of Treasury). Although the hearing took place on March 21, 1991, the hearing report was not available in time to be included in MCorp's principal brief.

a company engaging in nonfinancial commercial activities not permitted to a FSHC), to maintain the capital of subsidiary banks. Under the House Bill, if the FSHC or DHC fails to maintain the regulatory capital of a subsidiary bank, it could be required to divest the bank. H.R. 6 § 403(m). The House Committee Report states that under the Bill, "[l]ike the FSHC, the DHC must be separately capitalized and supervised. All holding companies would have to maintain their bank's capital requirements, *or divest their ownership in the bank.*"[9] (Emphasis added.)

On August 2, the Senate Banking Committee approved a bill, S. 543, which would grant a limited statutory source-of-strength assessment power to the FDIC, but not to the Board. Under this proposal, a bank holding company's maximum assessment liability would be limited to no more than five percent of its subsidiary bank's assets. The Senate Bill would create this power by extending to the parent company (but not to nonbank sister affiliates) of an FDIC-insured bank a portion of the liability for the "cross-guaranty" assessment created by Section 5(e) of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e). Under current law, the "cross-guaranty" liability of Section 1815(e) applies only to affiliated FDIC-insured depository institutions, and not to the parent company or other nonbank affiliates. As noted above and in MCorp's principal brief, the FDIC repeatedly has stated its position that source-of-strength assessments are *not* sound economic policy and has not requested this authority from Congress.

III. BOARD MISSTATEMENT OF FACTS CONCERNING THE CONTINUING EFFECTIVENESS OF TEMPORARY CEASE-AND-DESIST ORDERS AGAINST MCORP

The Board asserts in its Reply Brief that "the relevant provisions of the Board's October 1988 temporary order, which sought MCorp's compliance with the source of

[9] H.R. Rep. No. 157, 102d Cong., 1st Sess. at 119 (July 23, 1991).

strength policy, were suspended by the Board shortly after the order was issued, pending MCorp's negotiations with the FDIC . . . and they have no effect on MCorp." Reply Br. at 5-6 n.6; *accord* Reply Br. at 10 n.12. This assertion underlies the Board's contention that it has not yet asserted control over property of MCorp and that the "police or regulatory power" exception to the automatic stay, 11 U.S.C. § 362(b)(4), therefore should apply here. Reply Br. at 5. In fact, this assertion concerning the continuing effectiveness of the Board's three immediately effective temporary cease-and-desist orders issued against MCorp is factually incorrect.[10]

The Board issued not one but three separate temporary cease-and-desist orders in October 1988, each seeking MCorp's compliance with the source-of-strength policy, and none of which has been rescinded by the Board. Each of the three temporary cease-and-desist orders seeks MCorp's compliance with the source-of-strength policy by exercising direct control over the assets of MCorp's estate.[11] Indeed, the Board itself consistently has treated the three temporary orders as a unified "set" intended to enforce its alleged "source-of-strength" authority. For example, in its brief to the Fifth Circuit, the Board stated that it had "issued a set of temporary cease and

[10] The same factual error underpins the Board's argument that notwithstanding the explicit grant of jurisdiction to review an effective temporary cease-and-desist order contained in 12 U.S.C. § 1818(c)(2), *see* MCorp Br. at 27-28, there is no basis in this case "for a court to adjudicate the validity of the source of strength policy" as part of MCorp's challenge to the temporary cease-and-desist orders. Reply Br. at 10 n.12.

[11] The first two temporary cease-and-desist orders restrain the use or disposition of MCorp's assets, J.A. at 65-70, for the purpose of maintaining their availability to satisfy any source-of-strength assessment by the Board, J.A. at 63. The third temporary order requires MCorp to "take such actions as are necessary to use all of its assets to provide capital support to [MBanks] in need of additional capital," and to report to the Board with respect thereto. J.A. at 85.

desist orders designed to preserve its practical ability to enforce the source of strength requirements."[12]

The Board's assertion that it suspended the provisions of the Board's October 1988 temporary order apparently refers to a letter dated November 7, 1988, which temporarily "defer[red]" MCorp's obligation to comply with the third temporary order "during the time that . . . negotiations continue" between MCorp and the FDIC regarding a recapitalization of MCorp. J.A. at 184. The Board itself, however, has asserted that the deferral of MCorp's obligations under the third temporary order "did not . . . relieve MCorp of its duty to comply with the two initial temporary orders."[13] Moreover, this temporary deferral expired upon the FDIC's rejection of MCorp's recapilization proposal long ago. *See* J.A. at 203; Board Br. at 11. Since that time, the Board has not further "deferred" MCorp's obligations under any of the three temporary cease-and-desist orders, and none of the orders ever has been rescinded or withdrawn.

Indeed, subsequent to the expiration of the temporary deferral of the third temporary order, the Board confirmed the continuing effectiveness of all three temporary cease-and-desist orders in issuing the Second Amended Notice of Charges. The Second Amended Notice expressly recognizes the continuing effectiveness of all three temporary orders, stating that "[t]he provisions of this Second Amended Notice of Charges do not supersede, modify, or, any manner, affect the provisions of the Notice of Charges and of Hearing issued against MCorp . . . on March 30, 1989, *or the status of the temporary orders issued on October 19 and 26, 1988.*" J.A. at 194 (emphasis added).

[12] Board Brief in *MCorp et al.* v. *Board of Governors of the Federal Reserve System*, 5th Cir. No. 89-2816 at 6 (filed Aug. 14, 1989).

[13] Board Brief in *MCorp et al.* v. *Board of Governors of the Federal Reserve System*, S.D. Tex. No. H-89-1677 at 5 (filed May 25, 1989).

Thus contrary to the Board's assertion that the provisions of the temporary order "had been indefinitely suspended by the time of the district court action here," Reply Br. at 10 n.12, and therefore "have no effect on MCorp," Reply Br. at 6 n.6, the Board, by virtue of the outstanding temporary orders, once again will exercise immediate and direct control over the assets of the MCorp estate, unless all three temporary orders remain enjoined by the district court injunction. Therefore, the "police or regulatory power" exception does not insulate the Board's proceedings from the operation of the automatic stay under Section 362(a)(3) and (6) of the Bankruptcy Code.[14] *See MCorp* Br. at 15-17, 20-22.[15]

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[14] Furthermore, regardless of the applicability of the automatic stay under these circumstances, the continuing effectiveness of the three temporary orders on MCorp makes clear that the court below had jurisdiction to rule on the invalidity of the Board's source-of-strength assessment policy as part of MCorp's challenge to the temporary orders. *See* MCorp Br. at 27-28.

[15] We also wish to call to the Court's attention the reversal of a decision cited in *MCorp's* Brief. MCorp's Brief cited the decision of the bankruptcy court in *FirstCorp* v. *Office of Thrift Supervision*, 144 Bankr. 484 (Bankr. E.D.N.C. 1990). MCorp Br. at 14-16. On July 12, 1991, the District Court for the Eastern District of North Carolina, citing the Fifth Circuit's decision in this case, reversed that decision. *FirstCorp, Inc.* v. *Office of Thrift Supervision*, No. 91-180-CIV-5-BR, slip op. (E.D.N.C. July 12, 1991).

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SUPPLEMENTAL BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN RESPONSE TO THE SUPPLEMENTAL JOINT BRIEF OF MCORP, ET AL.

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SUPPLEMENTAL BRIEF FOR THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM IN RESPONSE TO THE SUPPLEMENTAL JOINT BRIEF OF MCORP, ET AL.

MCorp has filed a "supplemental" brief on the eve of oral argument to advise the Court of what it characterizes as "intervening developments," "matter that was not available in time to be included in the Joint Brief of MCorp," and a "material misstatement

of fact contained in" the government's reply brief. MCorp Supp. Br. 1. MCorp's filing—in reality, a surreply brief—takes this Court on yet another circuitous journey through irrelevant materials that serves no purpose except to obfuscate the issues.

1. *The "intervening development."* MCorp cites, as its intervening development, the government's filing of a brief in opposition, on behalf of the Federal Deposit Insurance Corporation, in *Bank of Coushatta* v. *FDIC*, No. 91-24 (filed August 16, 1991). See MCorp Supp. Br. 1-2. MCorp contends that a statement in a footnote in that brief in opposition is inconsistent with the government's position here. Not so.

The principal issue in *Bank of Coushatta* is whether an FDIC capital directive issued to a FDIC-insured bank is subject to judicial review under the Administrative Procedure Act (APA), 5 U.S.C. 701 *et seq.* In the course of that brief, we explained that the FDIC may issue a capital directive under the ILSA, 12 U.S.C. 3907(b)(2)(A), as an alternative to a cease-and-desist order under the FISA, 12 U.S.C. 1818(b), to compel an FDIC-insured bank to increase its capital.[1] See 91-24 Br. in Opp. 2 n.1.

The Bank of Coushatta argued that if a banking agency could issue an ILSA capital directive without subsequent APA review, that "would moot the source-of-strength issue in *MCorp* by providing a much more expeditious and reliable remedy to the banking agencies." 91-24 Pet. 15. We responded that

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[1] Section 3907(b)(2)(A) provides:

> In addition to, or in lieu of, any other action authorized by law, * * * the appropriate Federal banking agency may issue a directive to a banking institution that fails to maintain capital at or above its required level as established pursuant to subsection (a) of this section.

12 U.S.C. 3907(b)(2)(A).

the availability of a capital directive under 12 U.S.C. 3907 did not "moot" the issue in this case because "a capital directive cannot impose requirements on a bank holding company such as were imposed in *MCorp*." 91-24 Br. in Opp. 12 n.8.

Our point was that Section 3907(b)(2)(A) does not authorize the Board to issue a *capital directive* to a bank holding company to increase a *subsidiary* bank's capital, because the bank holding company is not a "banking institution" that has "fail[ed] to maintain capital at or above its required level." 12 U.S.C. 3907(b)(2)(A). The Board, however, may require a bank holding company to provide capital to subsidiary banks *under the FISA*, if it can show that the bank holding company's failure to act as a source of strength is an "unsafe or unsound practice." 12 U.S.C. 1818(b).[2]

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[2] MCorp misconstrues our brief in opposition in *Bank of Coushatta* as indicating that a capital directive "cannot be issued against a bank holding company." MCorp Supp. Br. 2. The Board *can* issue capital directives to a bank holding company requiring the bank holding company to increase its *own* capital. The Board has long had in place and has recently revised regulations providing for such capital directives. See 12 C.F.R. 263.35-.40 (1991); 56 Fed. Reg. 38,065-38,066 (1991) (to be codified at 12 C.F.R. 263.80-.85).

The Board has promulgated those regulations on the basis that while a bank holding company is not a "banking institution" within the meaning of Section 3907(a) of the ISLA, see 12 U.S.C. 3902(2), it is "an affiliate" of its subsidiary banks. The Board therefore has the power to issue capital directives to a bank holding company to increase its *own* capital under the authority of Section 3909(a)(2), which provides in relevant part:

> The appropriate Federal banking agency is authorized to apply the provisions of this chapter to any affiliate of an insured bank, but only to affiliates for which it is the appropriate Federal banking agency, in order to promote uni-

Contrary to MCorp's contention, our submissions in this case and in Bank of Coushatta are consistent and, indeed, reflect a careful reading of the relevant statutes. As we explained in our opening brief in this case, the ILSA recognizes that the failure to maintain adequate capital levels is an "unsafe or unsound" practice under the FISA. 12 U.S.C. 3907(b)(1). See U.S. Br. 38-39. As we explained in our brief in opposition in *Bank of Coushatta*, the ILSA does not authorize the issuance of a capital directive to a bank holding company to cure a subsidiary bank's capital deficiency. 12 U.S.C. 3907(b)(2)(A). See 91-24 Br. in Opp. 12 n.8. As we explained in *both* briefs, the Board may, however, bring a cease-and-desist proceeding under the FISA on the ground that the bank holding company's failure to provide capital to a subsidiary bank is an "unsafe or unsound" practice. 12 U.S.C. 1818(b). U.S. Br. 37-42; 91-24 Br. in Opp. 12 n.8. MCorp has attempted to manufacture an "intervening development" by simply quoting a statement in our brief in *Bank of Coushatta* out of context.

2. The *"matter that was not available in time to be included in the Joint Brief of MCorp."* MCorp next offers as new authority congressional testimony from the Securities and Exchange Commission and FDIC officials concerning pending banking legislation. MCorp Supp. Br. 2-7. MCorp asserts that the SEC/FDIC tes-

form application of this chapter or to prevent evasions thereof.

12 U.S.C. 3909(a)(2). As we pointed out in our brief in *Bank of Coushatta*, such directives do not involve requirements on a bank holding company of the sort at issue here. See 91-24 Br. in Opp. 12 n.8. Here, the Board is not directing MCorp to increase its own capital; rather, the Board seeks, by way of a cease-and-desist proceeding, to require MCorp to increase the capital of a *subsidiary* bank.

timony is critical of the "policy and economic wisdom" of imposing source-of-strength obligations in future legislation and that those criticisms "preclude any basis" for deference to the Board's interpretation of existing legislation. *Id.* at 4.

MCorp's argument is entirely misconceived. One might debate the value of legislative committee reports and floor statements in determining the meaning of legislation they address. Compare, *e.g.*, *Wisconsin Public Intervenor* v. *Mortier*, 111 S. Ct. 2476, 2484-2485 n.4 (1991), with *id.* at 2488-2490 (Scalia, J. concurring). But certainly, the testimony of committee *witnesses* on the wisdom of pending legislative *proposals* has no value in determining the meaning of *existing* legislation. The legislative testimony that MCorp submits is useless in interpreting the statutes involved here.[3]

3. *The "material misstatement of fact."* MCorp also errs in contending that the government made a "material misstatement of fact" in a footnote of the government's reply brief. MCorp Supp. Br. 7-10. MCorp argued in its opening brief that the Board had issued temporary cease-and-orders that "compel the transfer of assets of MCorp's estate." MCorp Br. 15. We responded in a footnote:

> [T]he relevant provisions of the Board's October 1988 temporary order, which sought MCorp's compliance with the source of strength policy, were suspended by the Board shortly after the order was issued, pending MCorp's negotiations with the FDIC. J.A. 184-185. The Board has not re-

[3] MCorp also reargues the wisdom of pending legislation that would impose source of strength requirements. See MCorp Br. 4-7. These proposals, which similarly provide no helpful guidance, were previously addressed in MCorp's opening brief. MCorp Br. 37-38. They are not new matters at all.

instated those provisions and they have no effect on MCorp.

U.S. Reply Br. 5-6 n.6; see also *id.* at 10 n.12. That statement is entirely accurate. Although the Board issued three temporary orders, J.A. 65-67, 68-70, 84-86, only *one* could be read to "compel the transfer of assets of MCorp's estate." MCorp Br. 15. The first temporary order directed that MCorp shall not "pay any corporate dividends" without prior Board approval. J.A. 66. The second temporary order directed that MCorp shall not enter into extraordinary transactions that have the effect of "dissipating" certain assets. J.A. 69-70. Those orders plainly did not "compel the transfer of assets." MCorp Br. 15.[4]

The only temporary order that even arguably had the effect of compelling the tranfer of assets was issued on October 26, 1988, and provided in relevant part:

> MCorp shall (a) take such actions as are necessary to use all of its assets to provide capital support to its Subsidiary Banks in need of capital, and (b) within 15 days of the effective date of this Temporary Order, report to the Board of Governors on the identity of those Subsidiary Banks into which capital injections will be made by MCorp and the amount of capital to be injected in each such bank.

J.A. 85. Four days later, however, the Board made clear that the order did "not require MCorp to take

[4] Indeed, MCorp's bankruptcy petition may have mooted those orders to the extent that MCorp, as a debtor in possession, is prohibited from paying dividends or dissipating assets. In any event, the Board has made no attempt to enforce those orders, and they are subject to judicial review in an independent district court proceeding. See note 6, *infra*.

any affirmative action with respect to MCorp assets prior to the submission of the report called for by the Order." J.A. 184. On November 7, 1988, the Board deferred the time for submitting the report "until five days following notice to MCorp by the Board." J.A. 184. The Board has *not* given such notice *nor* has it attempted to enforce the October 26 order.[5] Hence, our footnote responding to MCorp's argument is accurate. The only temporary order that even arguably "compel[s] the transfer of assets," MCorp Br. 15, has "no effect on MCorp." U.S. Reply Br. 5-6 n.6.

More importantly, the temporary orders that MCorp discusses are not relevant to the resolution of this case. The fundamental issue here is whether the Board may continue its administrative proceedings to determine *whether* MCorp should be subject to a *permanent* cease-and-desist order. That is what the Board seeks, see U.S. Br. 16-18; J.A. 13-14; that is what the FISA allows, see 12 U.S.C. 1818(b), (h) and (i); and that is what the district court injunction currently prevents, see J.A. 222. MCorp's assertion that the district court's injunction here should remain in place to protect MCorp from the temporary orders, MCorp Supp. Br. 10, is simply another red herring.[6]

[5] Contrary to MCorp's assertion, the Board's Second Amended Notice of Charges, issued in May 1989, did not change the suspended status of the temporary order. That Notice expressly states that it does not affect the "status" of the previously issued temporary orders. J.A. 194.

[6] As we discussed in our opening brief, Congress has provided MCorp with an avenue for immediate judicial relief from temporary orders. See U.S. Br. 5, 19-20. The appropriate district court may issue an injunction "setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order" pending the completion of the administrative proceedings for a permanent order. See 12 U.S.C. 1818(c)(2). Indeed, as

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MCorp acknowledges, it has filed such an action in the U.S. District Court for the Northern District of Texas, and that court has stayed its proceedings pending the outcome of this case. MCorp Br. 3; J.A. 174. Thus, if this Court dissolves the injunction issued in this case, MCorp can return to the U.S. District Court for the Northern District of Texas—its original forum of choice—for any further relief that may be appropriate with respect to the temporary orders. Notably, while MCorp argues that the temporary orders have "continuing effectiveness," MCorp Supp. Br. 9, MCorp fails to identify any such "effect." See note 4, *supra*. Thus, MCorp should return to the United States District Court for the Northern District of Texas, which currently has jurisdiction over the matter, to determine the continuing practical effect (if any) of those orders and the course (if necessary) of any future judicial proceedings.

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